NOTE

This Microfiche meets the quality requirements of the American National Standard for Microfiche of Documents (ANSI PH5.9-1975). However, because of imperfections in the document from which it was made, it contains images that are illegible or difficult to read. The source document for this microfiche is the best copy that could be obtained prior to filming.

CIS

Congressional Information Service,
Washington, D.C.

S. Hrg. 100-1022

RURAL DEVELOPMENT IN THE 1990'S

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDREDTH CONGRESS

SECOND SESSION

SEPTEMBER 28, 1988

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE
94-805 WASHINGTON : 1989

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

J841-10

JOINT ECONOMIC COMMITTEE

[Created pursuant to sec. 5(a) of Public Law 304, 79th Congress]

SENATE	HOUSE OF REPRESENTATIVES
PAUL S. SARBANES, Maryland, *Chairman*	LEE H. HAMILTON, Indiana, *Vice Chairman*
WILLIAM PROXMIRE, Wisconsin	AUGUSTUS F. HAWKINS, California
LLOYD BENSTEN, Texas	DAVID R. OBEY, Wisconsin
EDWARD M. KENNEDY, Massachusetts	JAMES H. SCHEUER, New York
JOHN MELCHER, Montana	FORTNEY H. (PETE) STARK, California
JEFF BINGAMAN, New Mexico	STEPHEN J. SOLARZ, New York
WILLIAM V. ROTH, Jr., Delaware	CHALMERS P. WYLIE, Ohio
STEVE SYMMS, Idaho	OLYMPIA J. SNOWE, Maine
ALFONSE M. D'AMATO, New York	HAMILTON FISH, Jr., New York
PETE WILSON, California	J. ALEX McMILLAN, North Carolina

Judith Davison, *Executive Director*
Richard F Kaufman, *General Counsel*
Stephen Quick, *Chief Economist*
Robert J. Tosterud, *Minority Assistant Director*

CONTENTS

WITNESSES AND STATEMENTS

Wednesday, September 28, 1988

Page
D'Amato, Hon. Alfonse M., member of the Joint Economic Committee: Opening statement ... 1
Snowe, Hon. Olympia J., member of the Joint Economic Committee: Opening statement ... 2
Sarbanes, Hon. Paul S., chairman of the Joint Economic Committee: Opening statement ... 5
Martin, Hon. John L., speaker, Maine House of Representatives ... 14
Daschle, Hon. Thomas A., a U.S. Senator from the State of South Dakota: Opening statement ... 27
Symms, Hon. Steve, member of the Joint Economic Committee: Opening statement ... 27
McClure, Hon. Mary, State senator and president pro tempore from South Dakota ... 58
Watkins, Hon. Wes, a U.S. Representative in Congress from the Third Congressional District of the State of Oklahoma ... 143
Jontz, Hon. Jim, a U.S. Representative in Congress from the Fifth Congressional District of the State of Indiana ... 156
Sims, Hon. Bill, Texas State senator ... 162
Leach, Hon. Robin, Kansas State representative ... 173
Lull, Murray D., on behalf of the American Bankers Association ... 181
Spies, John F., president, Iowa Trust & Savings Banks, Emmetsburg, IA, and member, Agriculture-Rural Committee, Independent Bankers Association of America ... 189
Cassidy, Jack E., vice president, corporate relations, National Bank for Cooperatives ... 197
Larochelle, Richard, legislative representative for rural and economic development, National Rural Electric Cooperative Association ... 208
Fulginiti, William, executive director, New Mexico Municipal League ... 246
Dunn, Michael V., director of legislative services, National Farmers Union ... 256

SUBMISSIONS FOR THE RECORD

Wednesday, September 28, 1988

Cassidy, Jack E.:
  Prepared statement, together with attachments ... 200
  Responses to additional written questions passed by the committee ... 295
Dunn, Michael V.: Prepared statement ... 259
Fulginiti, William: Prepared statement ... 251
Jontz, Hon. Jim: Prepared statement ... 159
Larochelle, Richard:
  Prepared statement, together with an attachment ... 211
  Reponses to additional written questions posed by the committee ... 298
Leach, Hon. Robin: Prepared statement ... 175
Lull, Murray, D.:
  Prepared statement ... 185
  Responses to additional written questions posed by the committee ... 282
Martin, Hon. John L.:
  Prepared statement ... 18
  Responses to additional written questions posed by Senator D'Amato ... 268
McClure, Hon. Mary: Prepared statement, together with attachments ... 62

Page

Sims, Hon. Bill:
  Prepared statement 167
  Responses to additional written questions posed by Senator D'Amato and the committee 278
Spies, John F.:
  Prepared statement 192
  Responses to additional written questions posed by the committee 291
Symms, Hon. Steve: Study entitled "The Rural Political Economy: Change and Challenge" 29
Watkins, Hon. Wes: Prepared statement 147
Wylie, Hon. Chalmers P.: Written opening statement 4

RURAL DEVELOPMENT IN THE 1990'S

WEDNESDAY, SEPTEMBER 28, 1988

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met, pursuant to notice, at 10:10 a.m., in room SD-628, Dirksen Senate Office Building, Hon. Paul S. Sarbanes (chairman of the committee) presiding.

Present: Senators Sarbanes, Proxmire, Melcher, Bingaman, Symms, D'Amato, and Daschle; and Representative Snowe.

Also present: Judith Davison, executive director; and David Freshwater, Dale Jahr, and Joe Cobb, professional staff members.

Senator SARBANES. The committee will come to order. I want to explain to our witnesses that because we're in the closing days of this session of the Congress there are a number of competing claims on the time of Members, not the least of which are votes that could take place at any moment, both in the House and in the Senate, and other conflicting committee requirements. So we may have to interrupt our proceedings as we go along in order to accommodate Members of the Senate and House.

I understand that Senator D'Amato has an opening statement, and I know he's involved in another committee—actually from which we both just came—and so I'll defer to him at this moment. I know he's anxious to comment on the subject matter that's before us.

OPENING STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. Well, Mr. Chairman, thank you so much for your graciousness, and thank you, Mr. Chairman, for calling this hearing because it's vitally important not only to those areas and States that we traditionally assume are agricultural and/or rural in nature, but to my State, the State of New York.

Now that might seem rather unusual because, generally, when people think of New York, they think of New York City. But the State of New York is just more than just Manhattan. In fact, agriculture is the State's No. 1 industry. It's a $4 billion industry, the agri-industry in New York.

As such, the State is no stranger to the unique problems and conditions of rural America. For many years, the rural economy was the backbone of our nation and of our State. Industrialization over a period of many years resulted in a shift away from a rural economy to an industrial one.

The rising tide of migration from rural to urban areas has also had a dramatic impact on a rural economy. Now, for instance, in

1987, over three-fourths of a million people—750,000—migrated to urban centers.

The magnitude of this shift becomes apparent when one compares that to the average rate of migration in the 1960's, and that migration was 170,000 annually.

Migration is not the only factor which is preventing economic prosperity in rural America. The lack of such necessary resources such as access to transportation, telecommunications, and capital have resulted in economic hardships in rural America.

Without these resources, it has become increasingly difficult for rural areas to attract industry and to build an economic base.

Mr. Chairman, while I'm not going to be able to participate in this hearing today, I certainly will be anxious to review the record, to get the recommendations of you and the committee because it certainly is important to the Nation and to my State, the great State of New York, as well. And I commend you for calling these hearings.

Senator **Sarbanes**. Thank you very much, Senator D'Amato.

Congresswoman Snowe, I know that you wanted to make some comments, I think, for the first panel. Perhaps you should do it now just in case you get called away by a floor vote.

OPENING STATEMENT OF REPRESENTATIVE SNOWE

Representative **Snowe**. Thank you, Mr. Chairman. As a Member who represents the largest district east of the Mississippi, I'm very pleased to see that the committee has decided to explore the issue of rural development and how best to assist those people living in rural areas who have not participated fully in our nation's ongoing economic expansion.

So I think that this action by the Joint Economic Committee and you, Mr. Chairman, is entirely appropriate, particularly if we anticipate a new President and a new Congress and the challenges of the 1990's.

At this hearing, we're going to be listening to three panels of distinguished witnesses. And I just want to personally welcome and introduce one of the panelists this morning, who happens to live in my district, and also happens to be the speaker of the Maine House of Representatives. And that is the Honorable John L. Martin.

Mr. Martin has served in the State legislature since 1964 and I served with him several years back in the 1970's. Most notably, he is serving an unprecedented seventh term as speaker of the Maine House of Representatives.

And also for the benefit of my colleagues, I should say that Eagle Lake, which is the speaker's hometown, has a population of 1,019, is in my district, and is in the largest county in my district. And also the county has a population of 91,000 and the people spread out over 6,400 square miles.

Translated, that means 15 people per square mile. So, Mr. Martin certainly is well qualified to speak on the issues of rural development and what the U.S. Congress can do to assist people living in rural America. I look forward to his testimony. I want to personally welcome him and the rest of the panel that's here this morning.

Senator **Sarbanes**. Thank you very much, Congresswoman Snowe.

I have an opening statement by the ranking Republican member of the committee, Congressman Chalmers Wylie, which will be included in the record, and I just want to paraphrase from just a couple of parts of it.

He expresses his pleasure at the committee holding this hearing of national importance, and he particularly wants to extend a warm welcome to the State legislators from across the country who are bringing us the benefit of their expertise and their perspective on rural issues.

He underscores the longstanding tradition of involvement of this committee in matters concerning the rural economy, and notes that he and I have joined in requesting the Office of Technology Assessment, one of the special offices that serves the Congress, to conduct a study on the effects of information age technology on rural America.

Obviously, the use of telecommunications and computer technology is changing the way we live and work and I think we need to take a careful look at its impact on the rural economy of our country.

Before giving my opening statement, I will place Congressman Wylie's opening statement in the record at this point.

[The written opening statement follows:]

WRITTEN OPENING STATEMENT OF REPRESENTATIVE WYLIE

Mr. Chairman, I commend you for convening this hearing of national importance, and welcome our distinguished witnesses.

It is a special pleasure and honor to have a panel of State Legislators from across the country. These dedicated public officials can lend their expertise and perspective on rural issues. Their recommendations on rural policy and the appropriate role of the Federal Government will be most appreciated.

Our other witnesses will add to the depth and breadth of this hearing. Their testimony on the important issues of credit and infrastructure -- the financial lifeblood and physical foundation of communities -- will contribute to the public record in valuable ways.

Mr. Chairman, our committee has a longstanding tradition of involvement in the rural economy, and I am pleased our attention is continuing with this hearing today. I am also pleased to have joined you in requesting the Office of Technology Assessment to conduct a study on the effects of information age technology on rural America. The use of telecommunications and computer technology is changing the way we live and work, and its impact on the economy is profound.

The Congress needs to be aware of how emerging technologies and their benefits are distributed in society. Technical applications oftentimes require large economies of scale in order to be cost-effective. Rural areas may not readily be in a position to harness state-of-the-art technology. Yet, if they are not, they are at a disadvantage to participate in an increasingly competitive and global economy.

This hearing will lend us guidance and foresight into rural issues of the present and future, and we are grateful for your appearance today.

OPENING STATEMENT OF SENATOR SARBANES, CHAIRMAN

Senator **Sarbanes**. We meet this morning to assess the current status of rural America. This hearing does indeed reflect the committee's longstanding concern for the condition of the economic base of rural America and the broad underlying issues of rural development.

It is a concern which has intensified as the rural economy has deteriorated in recent years and rural dislocation has grown more severe. The trends of the 1980's have reflected a sharp departure from the trends of the previous decade, in many critical respects reversing them. In the 1970's, the gap in income and employment levels between rural and urban Americans narrowed. In many parts of the country, the rural population grew and a rural renaissance appeared to be a realistic possibility.

In the 1980's, in contrast, the gap in income and employment has widened significantly. The rural population has declined dramatically in many areas and the hopeful expectations of a rural renaissance have given way to a sober reassessment. In fact, Newsweek in its early August issue called rural America America's Third World and offered this summary of recent trends:

> In the past decade, broad downturns in low-tech manufacturing, mining, agriculture, and oil have cut median rural income from 80 percent of U.S. urban income to 73 percent. Many economists expect that slide to continue. Seven of every eight new U.S. jobs are in metropolitan areas and the rural jobs often pay only near minimum wage.

This analysis by Newsweek is only one of several which have appeared in the national press in recent months. All underscore the fact that, while rural economic decline and the farm crisis of the 1980's are interrelated, the problems of rural America are not limited to its farms.

As the Wall Street Journal noted in the first of two major articles which appeared just this past August under the title "Quiet Crisis":

> The U.S. has been suffering more than a farm crisis or a drought, more than a cyclical downturn in the western resource belt. It is in the midst of a coast to coast, border to border collapse of much of its rural economy.

These and other analyses have focused attention on striking aspects of the rural phenomenon of this decade, including depopulation. According to a Wall Street Journal article entitled "People Flee as Jobs Disappear," over the past decade we have seen the growth of what could become a new generation of the ghost towns of a century ago.

What is more, it is the younger, better educated members of the rural population who are most likely to leave. One rural sociologist has observed that rural communities won't just shut off the lights, but they'll become pockets of elderly people.

A second trend has been declining employment opportunities and rising unemployment. Unemployment rates in America's nonmetropolitan counties have remained more than 2 points higher than rates in metropolitan counties throughout this decade, and unemployment in nonmetro areas last year was only 30 percent below its recession high point. Obviously, unemployment and depopulation go hand in hand and the prospect of unemployment constitutes a major incentive for outmigration.

A third trend is inadequate capital formation. The constant dollar value of the capital stock in industries characteristic of rural areas has not increased over the decade.

With respect to the physical infrastructure investments on which growth also depends, the recent report of the National Council on Public Works Improvement notes the need for rural physical infrastructure. Actually, 4 years ago, in its study entitled "Hard Choices," this committee outlined the growing infrastructure problems in a manner that has since made us to appear to be prophets.

A fourth trend is erosion of the revenue base and declining services. With shrinking employment opportunities and rising unemployment, tax revenues have declined and the financial base for essential community services has been weakened. As the Wall Street Journal noted:

> Despite having far fewer residents than a generation ago and a shrunken tax base, many rural communities still face the relatively unchanged costs of maintaining schools, sewers and roads.

These trends must be set against the background of a decade of profound and sweeping changes and Federal policies, macroeconomic policy, tax policy, infrastructure and transportation policies.

Rural life has been profoundly affected by these changes. The committee's immediate task is to examine the complex interrelationships which have contributed to and, in some cases, even precipitated this stark deterioration in rural economic conditions. Our task in the longer run is to help to define policy that will make possible the restoration of vigorous economic life in our rural communities.

I have just a few charts that I want to make reference to this morning, to underscore some of the points in my opening statement. Then I'll ask the staff to put up some others as well.

The one on the far side shows the difference in unemployment rates between metro and nonmetro counties over the 1976–87 period. What it indicates is that, in 1976 and 1977 the nonmetro areas were doing better, as a matter of fact. Since then, the nonmetro areas show a higher unemployment rate by the margin indicated by those bars. And as we can see, the gap has expanded.

So, as I indicated earlier, the unemployment rate in the nonmetro areas is now better than 2 points higher than in the metro areas. This obviously represents a very sharp change from the situation that prevailed in the mid–1970's.

The second chart, the one closest to me, shows the net migration for rural areas. Again, it shows that in 1980–81 and 1981–82, there was, in fact, some inmigration.

Since that time, there's been outmigration. And as we can see, it has worsened.

When we examine the outmigration by educational levels, which is what this next chart shows—and it refers back to something I said in my opening statement—we can see that the outmigration increase almost in direct correlation to education, with the one exception of years of schooling between 9 and 11 years.

The first bar indicates those with under 9 years of schooling. For those with 9 to 11 years there's a little less outmigration. And then, from then on, 12 years, 1 to 3 years of college, 4 years of college or more, as you can see, the amount of outmigration increases very sharply.

We can see here labor force participation rates, urban and rural areas. Actually the labor force participation rate in the urban areas has always been above that in the rural areas, but the significant point here is the widening gap which has taken place in recent years. As you can see, the rate has widened between urban and rural areas in the country.

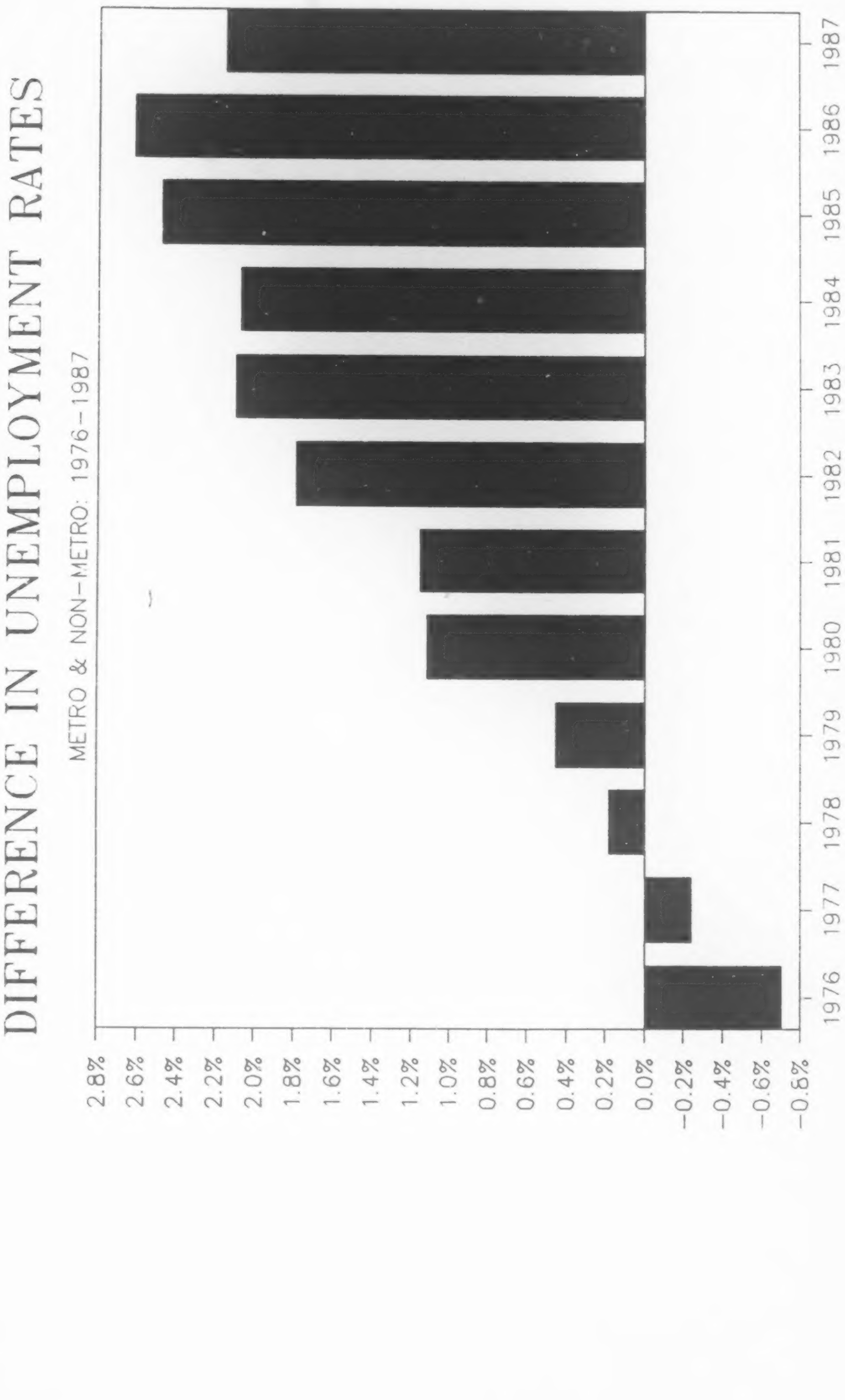
The next chart shows the educational level of adults in rural and urban areas. The heavy bar is rural areas; the striped bar is urban areas. And as you can see, once again it shows lower levels of performance in rural areas. To some extent, it also reflects the outmigration figures as well.

And then I think we have one final chart, showing rural per capita income as a percent of urban per capita income.

In 1969, rural per capita income was 71 percent of urban per capita income. It then rose, as you can see, to 78 percent—approaching 80 percent really—in the early 1970's. This chart really, in effect, backs up the comments I was making about the seventies.

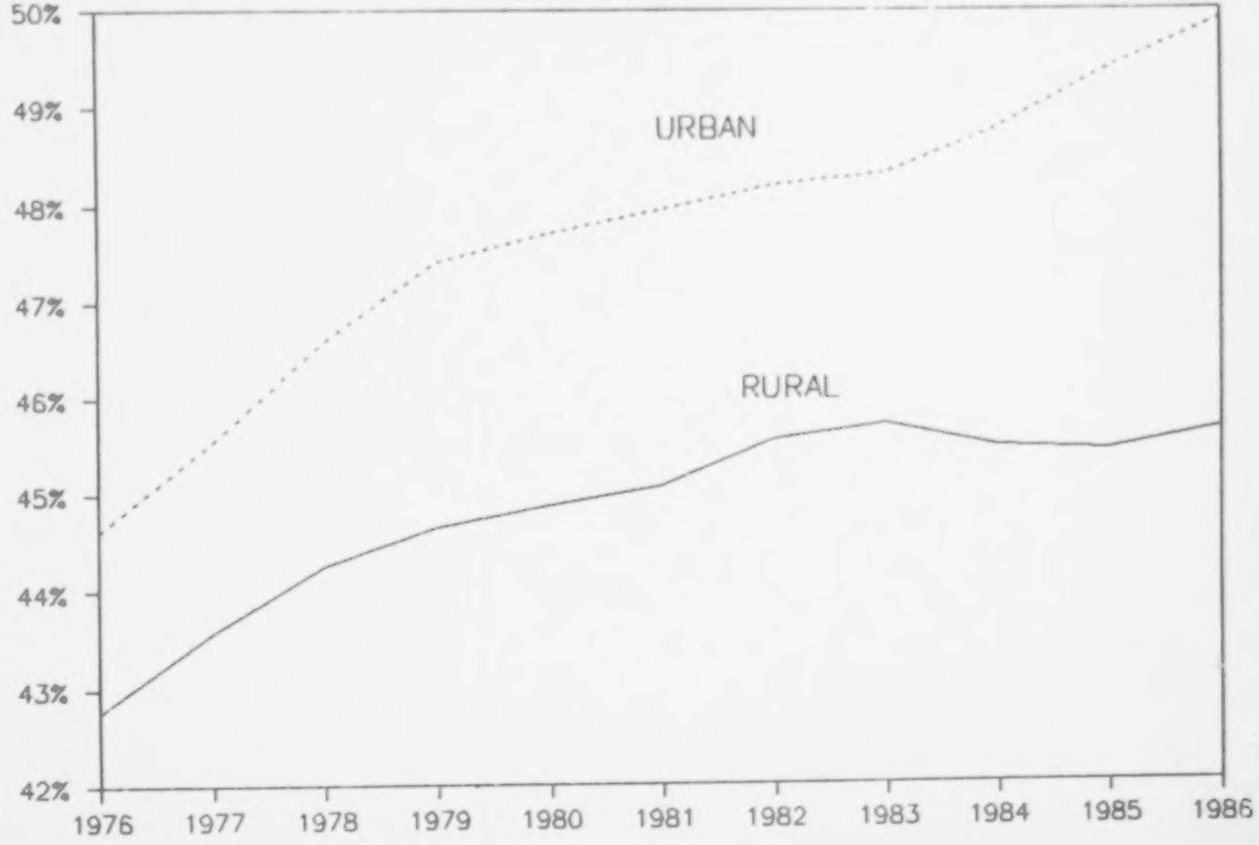
What's happened since is that we've had a decline, so that rural per capita income as a percent of urban per capita income is now moving back down toward the 70-percent level.

[The charts made reference to in Senator Sarbanes' opening statement follow:]

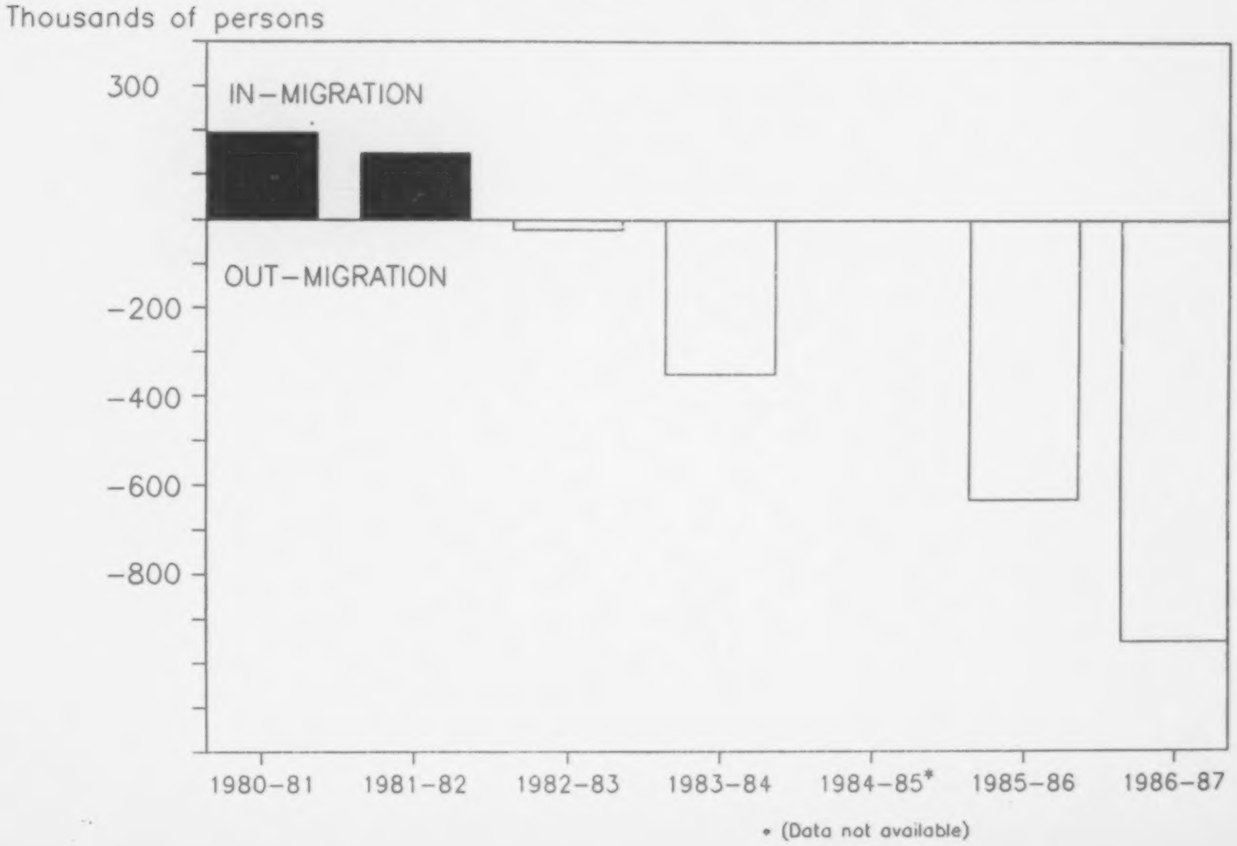

DIFFERENCE IN UNEMPLOYMENT RATES
METRO & NON-METRO: 1976-1987
2.8%
2.6%
2.4%
2.2%
2.0%
1.8%
1.6%
1.4%
1.2%
1.0%
0.8%
0.6%
0.4%
0.2%
0.0%
-0.2%
-0.4%
-0.6%
-0.8%
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987

LABOR FORCE PARTICIPATION RATES

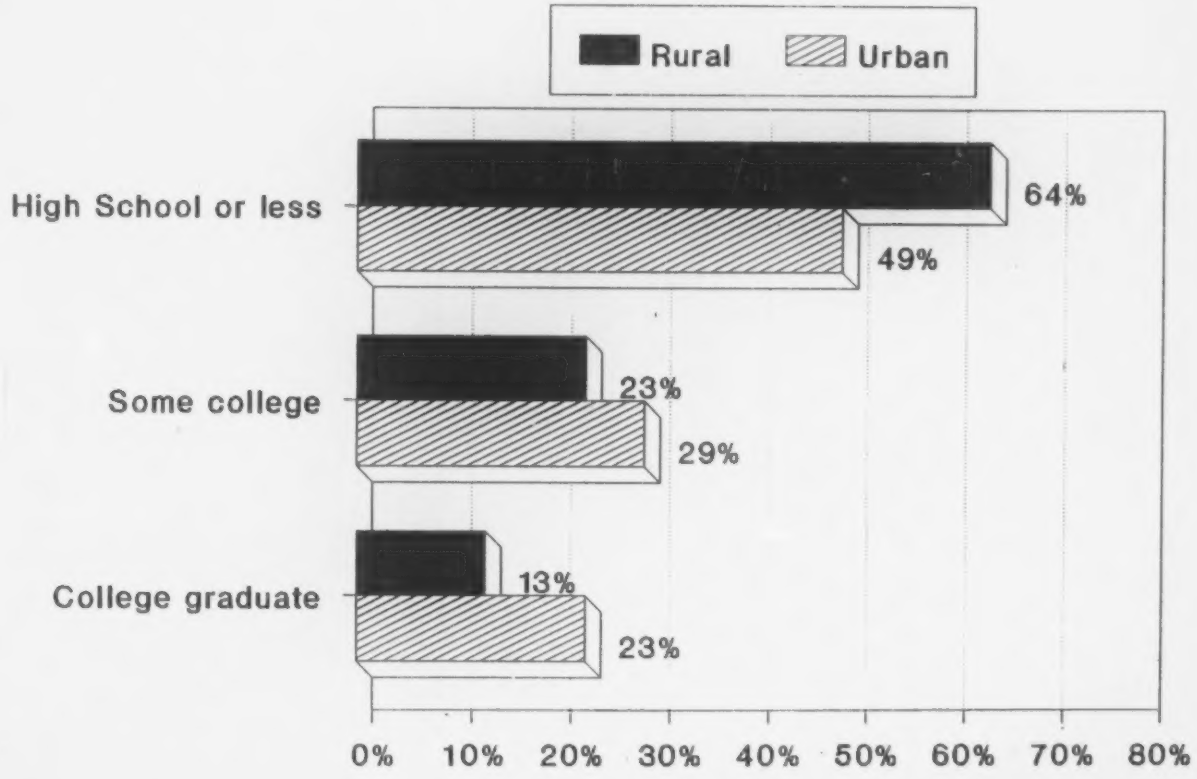
RURAL VS. URBAN



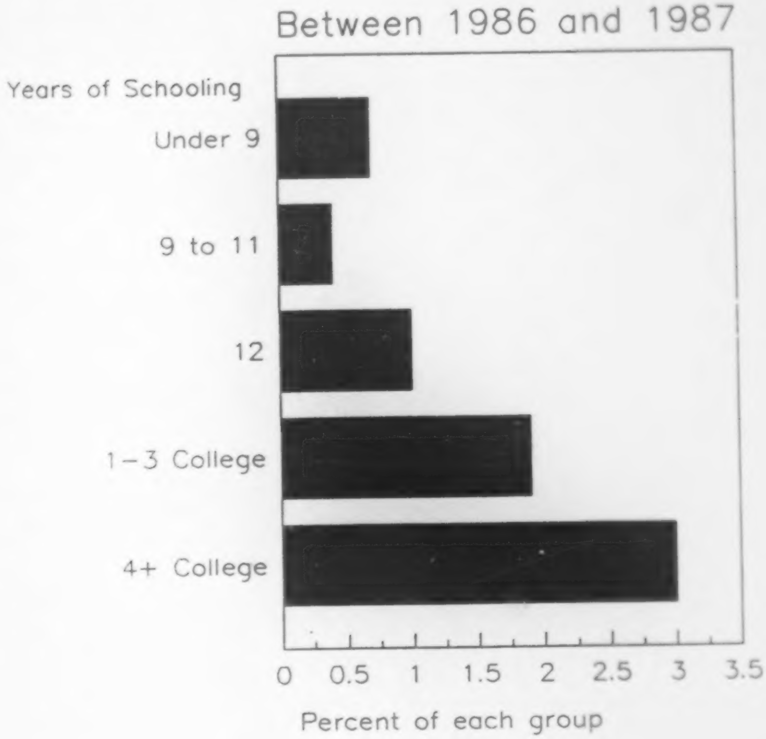
NET MIGRATION FOR RURAL AREAS

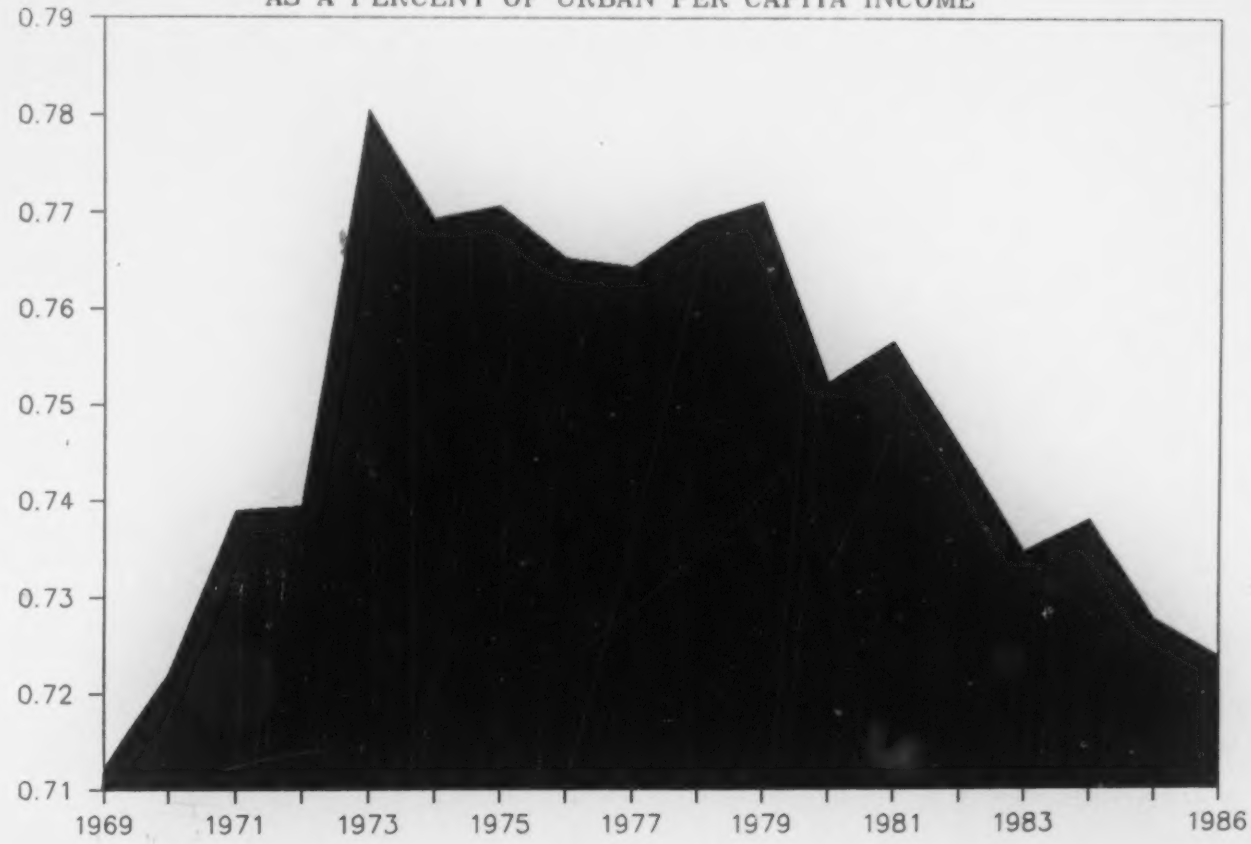


EDUCATIONAL LEVEL OF ADULTS



OUTMIGRATION BY EDUCATIONAL LEVEL





RURAL PER CAPITA INCOME

AS A PERCENT OF URBAN PER CAPITA INCOME

Senator **Sarbanes**. With that by way of background, let me simply say that what the committee has arranged is an extended hearing this morning with some very distinguished witnesses. We have three panels this morning.

First, a panel of State legislators—and we're very pleased to have you with us; next a panel of representatives of institutions that provide credit in rural areas, which is obviously always very critical to the functioning of the economy. And, finally, a panel on the critical question of physical infrastructure.

The committee has also requested the Congressional Research Service of the Library of Congress to plan and hold a symposium, which will take place all day tomorrow and for half a day on Friday, on approaches to rural development policy for the 1990's, to expand income and employment opportunities.

That symposium will begin at 8:30 tomorrow morning in the Madison Building of the Library of Congress. It will continue through the day and then resume again on Friday morning.

I want to express here at this hearing our very deep appreciation to the Congressional Research Service for arranging its usually fine program. They've brought in some of the best academics and professional people in the country in order to discuss this very important matter.

Now we'll proceed to our first panel. I will ask the four State legislators who are here with us to come forward and take their seats at the table.

We're very pleased to have four distinguished members of our fellow legislative bodies from across the country here with us this morning.

Mr. Martin, we will begin with you. Congresswoman Snowe has already given you a very fine introduction. I must say I've heard so much about you from my colleague, Senator George Mitchell, over the years that I'm delighted to have this chance to have you before the committee. And I know you're vice-president-elect of the National Conference of State Legislators.

So we're very pleased to have you with us. And if you could go ahead, and then we'll move to your fellow panel members.

STATEMENT OF HON. JOHN L. MARTIN, SPEAKER, MAINE HOUSE OF REPRESENTATIVES

Mr. **Martin**. Thank you very much, Senator. I also want, for the record, to thank very much the introduction by Congresswoman Snowe. She, in fact, was a member of the Maine House of Representatives for 4 years while I began my terms as speaker, and she was a very effective member of the house.

I would like to, you all have copies of my prepared statement, highlight some of the points and make some additional comments about the subject matter.

As defined by the U.S. Government, there's no question that the vast majority of the State of Maine is classified as being of a rural economy.

The only area that's defined as urban at all, of course, is the Portland-South Portland area, with about 100,000 people and is the State's financial center.

During the last 6 years, a large portion of the population in Maine, which is located in the southern part of the State, in particular in two counties, York and Cumberland, has reaped the benefits of a strong economic growth that has occurred in the State; while at the same time, statistics do not pull through for the rest of Maine.

The labor market in southern Maine has currently less than 3 percent unemployment and the rest of the State is 4.7 percent. And, yet, in some of the rural areas of Maine, the rate is closer to 14 and 15 percent at this very moment.

So, statistics are deceiving. If you look at the entire State, it appears that we are doing extremely well at 4.3 percent, which is what it is right now, but, in reality, many of the people in Maine are not benefiting from what is happening, especially in the rural areas of the State.

The same is true in terms of the jobs and the salaries that are being paid to those people who find themselves working in northern Maine versus southern Maine.

As a result, it creates disparity among the State workers and, as a result, a movement of migration, in particular, my own county of Aroostook, which, as Congresswoman Snowe pointed out, is the largest county in Maine—and I do represent the largest district within that county—we have lost better than 30,000 people in the last 20 years.

One of the things that we have made some efforts to do is to try to do what we could at the State level to improve the economic development of the entire State.

But we have attempted, if at all possible, to also gear that kind of development to rural areas to a greater degree. We created in 1983 an organization known as FAME, the Finance Authority of Maine.

The agency is responsible for administering financial assistance programs and to assist industries that are economically disadvantaged.

We have created better than two dozen programs under this particular law and I would point out that some of them are aimed in particular to agriculture and, in particular, to potatoes, which, obviously, is the chief source of income as far as agriculture is concerned, in Aroostook County.

The program offers direct loans to potato growers and packers to improve the quality and the marketing of Maine potatoes and it provides for long-term, fixed-rate loans at low interest.

It also provides a program which we created about 4 years ago, known as the Maine Job Start Program, one of those that I was the sponsor of on behalf of then Governor Brennen, now a Member of Congress, which has been a tremendous benefit to people who were on AFDC, who were low income.

The program offers moneys to people who have the ability to start off a program or perhaps an industry and offers the interest rate at 2 percent below the prime rate.

And I will leave with the staff the report of FAME and all of the programs that are offered with it because it also is responsible for administering the Energy Conservation Program, an underground oil storage facility program, an occupational safety program, and commercial loan program, all of which are at a lower interest rate than available elsewhere.

We have financed better than 1,400 businesses and retained or re-created 35,000 jobs through the program.

One of the things that the Chair of this committee asked that we discuss was:

What do we do in the next several years?

Well, I would like to point out a couple of things. Maine is one of those States that will be affected by the recently ratified United States-Canada Free Trade Agreement. All of Maine's congressional delegation, both U.S. Senators and both Members of the U.S. House of Representatives voted against ratification of the trade agreement.

The reason, of course, is very simple:

All of the State's three major industries will be drastically affected, particularly agriculture, fisheries, and lumber.

The impact on that will be severe in the short term, if not in the long term.

I would ask in terms of what it is we can do, in terms of what this Congress can do to help rural areas, and that is to make sure that we have the ability to get money at a rate of interest that is not above the prime rate.

If you look at what other nations in the world are providing for available moneys and resources to start businesses or to maintain, you're talking about prime rates in Japan of 3 percent, in Germany 6 percent, in Switzerland 6 percent. In this country, we're at 10 percent and the only people who can get that, of course, are General Motors, IBM, and General Electric, et cetera.

But, the small corporation is simply not going to be able to do that. In Maine, where 98 percent of all jobs are created by people with less than 100 employees, obviously, we're not talking about large corporations existing. And the rate for which they can borrow money is between 12 to 16 percent.

We cannot compete with the potato farmer in New Brunswick, Canada, when they are subsidizing their rate of interest. We cannot compete with what is going on with lumber mills in foreign countries. And the shoe manufacturer in Dexter, for example, cannot compete with the shoe manufacturer in Korea.

We need to have a long-term debt equity availability in the public market as well as in the private. It seems to me that one of the things that I would ask Congress to consider, if at all possible, is to solve the problem of the repeal of the Small Issue Industrial Development Bond Program, which is due to expire in 1989.

It is obvious, the fact that a few companies—Burger King, K-Mart, and others—built retail stores using the program, and the fact that baseball stadiums and sky boxes were constructed with the proceeds of the bonds, resulted in a black eye for the entire program.

I think that it's simply a case of where bad apples got into the whole barrel or bushel. And it seems to me that what we should do is try to save the program and to restrict the guidelines sufficiently that this kind of thing doesn't happen again.

A small mill that is located in my district in Ashland making cedar shingles needs to compete with Canada, but can't borrow because the interest rate is double the rate in other countries. The same is happening with the salmon hatchery off the coast of Eastport and a food processing plant in Limestone.

While these kinds of industries should be getting those loans, a 75-store shopping mall in Portland should not. I firmly believe that if you can provide an economically depressed area the ability to help itself, I think it can be done.

And so, when the members of the Joint Economic Committee consider legislation, I would urge you to think in terms of Maine and also to think not in terms of whether or not we're competing with other States but rather I think we need to now think in terms of America competing against the entire world—not one State against the other.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Martin follows:]

PREPARED STATEMENT OF HON. JOHN L. MARTIN

AS DEFINED BY THE UNITED STATES GOVERNMENT, THE VAST MAJORITY OF THE STATE OF MAINE IS CLASSIFIED AS RURAL.

THE METROPOLITAN AREA OF PORTLAND/SOUTH PORTLAND STANDS AS THE ONLY EXCEPTION, BEING HOME TO APPROXIMATELY 100 THOUSAND PEOPLE AND THE STATE'S MAJOR FINANCIAL CENTER.

DURING THE LAST SIX YEARS, A LARGE PORTION OF OUR POPULATION, LOCATED IN THE EXTREME SOUTHERN SECTION OF MAINE, HAS REAPED THE BENEFITS OF A STRONG ECONOMIC BOOM. UNEMPLOYMENT RATES IN THIS REGION OF THE STATE HAVE, FOR MOST OF THE LAST SIX YEARS, BEEN CONSISTENTLY BELOW THE NATIONAL AVERAGE.

STATISTICS SHOW THAT THE UNEMPLOYMENT RATE IN THE PORTLAND/SOUTH PORTLAND LABOR MARKET IS CURRENTLY BELOW THREE PERCENT.

DURING THE SIX YEAR PERIOD, SINCE 1982, THE STATEWIDE UNEMPLOYMENT RATE HAS ALSO BEEN BELOW THE NATIONAL AVERAGE. TODAY, THAT RATE IS 4.7 PERCENT.

THESE STATISTICS ARE, HOWEVER, SOMEWHAT DECEIVING. A CLOSER EXAMINATION REVEALS UNEMPLOYMENT RATES OF MORE THAN TEN PERCENT IN THE SMALLER RURAL TOWNS THAT COMPRISE NORTHERN AND EASTERN MAINE.

MOREOVER, THE WAGE AND BENEFIT PACKAGE OFFERED TO EMPLOYEES IN NORTHERN AND EASTERN MAINE IS, FOR THE MOST PART, FAR BELOW THAT WHICH IS OFFERED TO SOUTHERN MAINE EMPLOYEES IN IDENTICAL OCCUPATIONS.

FOR EXAMPLE, IT IS NOT UNCOMMON FOR A LEGAL SECRETARY IN THE CITY OF PORTLAND TO MAKE MORE THAN TWENTY THOUSAND DOLLARS ANNUALLY.

THAT SAME LEGAL SECRETARY, IF WORKING IN CARIBOU, A TOWN 350 MILES NORTH OF PORTLAND, WOULD PROBABLY EARN LESS THAN ELEVEN THOUSAND DOLLARS PER YEAR.

A WELDER IN PRESQUE ISLE, MAINE CAN EXPECT TO MAKE SIX DOLLARS AN HOUR. WHILE A WELDER WORKING AT BATH IRON WORKS IN PORTLAND WOULD NOT HAVE TO SETTLE FOR LESS THAN THREE TIMES THAT AMOUNT.

TO COMPENSATE FOR THE DISPARITY BETWEEN URBAN SOUTHERN SECTIONS OF MAINE AND RURAL NORTHERN AND EASTERN SECTIONS OFTHE STATE, THE MAINE LEGISLATURE HAS IMPLEMENTED A NUMBER OF BUSINESS ASSISTANCE PROGRAMS DESIGNED TO ENCOURAGE DEVELOPMENT

AND EXPANSION IN RURAL AREAS.

PERHAPS THE MOST VISIBLE ACTION TAKEN BY MAINE GOVERNMENT WAS THE CREATION OF A STATE FINANCING AGENCY KNOWN AS THE FINANCE AUTHORITY OF MAINE (FAME). FAME ADMINISTERS A NUMBER OF BUSINESS AND ECONOMIC DEVELOPMENT PROGRAMS IN CONJUNCTION WITH ESTABLISHED STATE AGENCIES, LIKE THE DEPARTMENT OF ECONOMIC AND COMMUNITY DEVELOPMENT, THE DEPARTMENT OF AGRICULTURE, AND THE DEPARTMENT OF LABOR.

THIS AGENCY IS RESPONSIBLE FOR ADMINISTERING FINANCIAL ASSISTANCE PROGRAMS TO ALL AREAS OF MAINE. HOWEVER, THEY HAVE A SPECIAL CHARGE WHICH URGES THEM TO ASSIST AREAS AND INDUSTRIES WHICH ARE ECONOMICALLY DISADVANTAGED. SINCE 1983, LAWMAKERS, IN AN EFFORT TO HELP FAME MEET ITS LEGISLATIVE MANDATE, HAVE ENACTED MORE THAN TWO DOZEN DIFFERENT PROGRAMS AIMED AT HELPING MEET THE UNIQUE AND VARIED NEEDS OF THE STATE'S BUSINESS COMMUNITY. THE FACT IS, THE MAJORITY OF ELIGIBLE RECIPIENTS FOR THESE PROGRAMS ARE LOCATED IN "RURAL" AREAS.

THROUGH FAME, THE STATE HAS DIRECTED A GOOD NUMBER OF ITSBUSINESS DEVELOPMENT PROGRAMS TOWARD REVITALIZING THOSE AREAS OF MAINE AND THOSE INDUSTRIES WHOSE ECONOMIC PICTURE REMAINS VIRTUALLY STAGNANT, DESPITE THE SUSTAINED ECONOMIC RESURGENCE IN OTHER AREAS OF THE STATE AND OTHER INDUSTRIES.

ONE OF THE NEWEST PROGRAMS INITIATED BY THE LEGISLATURE AND COORDINATED THROUGH FAME IS THE POTATO MARKETING IMPROVEMENT

FUND. THIS PROGRAM OFFERS DIRECT LOANS TO POTATO GROWERS AND PACKERS TO IMPROVE THE QUALITY AND MARKETING OF MAINE POTATOES. THIS FUND PROVIDES LONG-TERM, FIXED-RATE LOANS AT ATTRACTIVE, LOW INTEREST RATES TO HELP FINANCE CONSTRUCTION OR IMPROVEMENTS TO STORAGE AND PACKING FACILITIES. THE PROGRAMS HAVE ENABLED STRUGGLING POTATO FARMERS TO CONTINUE UPGRADING THEIR OPERATION AND THEIR QUALITY STANDARDS IN AN EFFORT TO CAPTURE A LARGER PORTION OF THE NATIONAL AND INTERNATIONAL POTATO MARKET.

ANOTHER EXAMPLE OF THE TYPE OF PROGRAM OFFERED THROUGH THE FINANCE AUTHORITY OF MAINE IS THE MAINE JOB START PROGRAM. THE JOB START PROGRAM IS A REVOLVING LOAN PROGRAM DESIGNED TO PROVIDE THE SMALL BUSINESS PERSON WITH THE NECESSARY CAPITAL TO START, STRENGTHEN, OR EXPAND A BUSINESS OPERATION. IT IS TARGETED AT THOSE SMALL BUSINESSES WHICH CANNOT OBTAIN FINANCING THROUGH CONVENTIONAL SOURCES. THE INTEREST RATE FOR THIS PROGRAM IS CURRENTLY AT TWO PERCENT BELOW THE PRIME RATE. SMALL BUSINESS PEOPLE WHO MAY HAVE THE INGENUITY BUT NOT THE CAPITAL ARE NOW GIVEN THE OPPORTUNITY TO PUT THEIR IDEAS TO WORK WHILE HELPING PUT MAINE PEOPLE TO WORK.

ANOTHER FAME PROGRAM INCLUDES THE MAINE OPPORTUNITY JOB GRANTS PROGRAM. ESTABLISHED IN 1987, THE PROGRAM IS DESIGNED TO PROVIDE BUSINESSES WHICH LOCATE IN DESIGNATED JOB OPPORTUNITY ZONES WITH UP TO $1,250 DIRECT GRANTS FOR THE CREATION OF EACH NEW FULL-TIME QUALITY JOB.

FAME IS ALSO RESPONSIBLE FOR ADMINISTERING THE ENERGY CONSERVATION LOAN PROGRAM, THE UNDERGROUND OIL STORAGE FACILITY PROGRAM, THE OCCUPATIONAL SAFETY LOAN PROGRAM AND THE COMMERCIAL LOAN INSURANCE PROGRAM, TO NAME JUST A FEW.

IN FIVE YEARS, STATE ASSISTED FINANCING EXCEEDS 750 MILLION DOLLARS. THAT FINANCING HAS HELPED MORE THAN 1,400 BUSINESSES WHILE CREATING AND RETAINING MORE THAN 35,000 JOBS.

IN CHAIRMAN SARBANES LETTER, HE REQUESTED THAT I DISCUSS THE ECONOMIC PERFORMANCE OF THESE RURAL AREAS DURING THE LAST SEVERAL YEARS. A SHORT ANSWER WOULD BE THAT THESE AREAS HAVE ENJOYED A DEGREE OF SUCCESS, ALBEIT SMALL. HOWEVER, AT LEAST FROM MY PERSPECTIVE, MUCH MORE NEEDS TO BE ACCOMPLISHED.

THE RURAL AREAS I HAVE DESCRIBED ACCOUNT FOR APPROXIMATELY SEVENTY PERCENT OF THE ENTIRE STATE'S LAND MASS. MUCH OF THE STATES ECONOMIC FOUNDATION IS FOUND IN THESE RURAL AREAS.

THAT FOUNDATION INCLUDES OUR LUMBER AND PAPER INDUSTRIES, FISHERIES AND AGRICULTURE, TOURISM AND LEATHER GOODS, JUST TO NAME A FEW. IN FACT, THESE RURAL AREAS ARE HOME TO A LARGE NUMBER OF MANUFACTURING JOBS. THESE ARE THE JOBS WHICH ACCOUNT FOR THE MAJORITY OF THE STATE'S G.N.P.

UNFORTUNATELY, A STATE THE SIZE OF MAINE CAN NOT AFFORD TO REPLACE ALL THE FEDERAL MONIES WHICH HAVE BEEN LOST DURING THE LAST EIGHT YEARS OF NEW FEDERALISM. WHILE WE AS A STATE LEGISLATURE HAVE ATTEMPTED TO REPLACE AS MANY FEDERAL PROGRAMS AS POSSIBLE, WE FIND OURSELVES NEARING THE END OF OUR FISCAL

RESOURCES. MOREOVER, THE RECENTLY RATIFIED U.S./CANADA FREE TRADE AGREEMENT WILL MOST ASSUREDLY FURTHER HINDER MAINE'S PROGRESS.

MAINE, AS MANY OF YOU KNOW, NOT ONLY SUFFERS THE ACHES AND PAINS COMMON TO MATURING INDUSTRIES, BUT WE ALSO SUFFER THE DISASTROUS EFFECTS OF FOREIGN COMPETITION WHICH IS OFTEN HEAVILY SUBSIDIZED.

VIRTUALLY EVERY MAJOR MANUFACTURING INDUSTRY IN OUR STATE COMPETES IN THE GLOBAL MARKETPLACE. IN FACT, TODAY MORE THAN SEVENTY PERCENT OF THE MANUFACTURED GOODS PRODUCED IN THIS COUNTRY FIND THEMSELVES FACING FOREIGN COMPETITION. HOWEVER, THE FIRMS WE FIND OURSELVES COMPETING AGAINST ARE COMPANIES THAT ARE ENJOYING GOVERNMENT GRANTS, TAX CREDITS, LOW INTEREST LOANS AND SCORES OF OTHER TYPES OF FOREIGN GOVERNMENTAL ASSISTANCE.

WHICH BRINGS ME TO THE PROGRAM I WOULD LIKE TO TALK ABOUT.

ON DECEMBER 31, 1989, THE SMALL ISSUE TAX EXEMPT BOND PROGRAM IS SCHEDULED TO SUNSET. IF THIS IS ALLOWED TO HAPPEN, BUSINESSES THROUGHOUT MAINE, AND I DARE SAY THROUGHOUT THIS COUNTRY, WILL FIND THEMSELVES IN AN EVEN MORE DIFFICULT POSITION GLOBALLY.

WITNESS THE FACT THAT TODAY IN JAPAN, BUSINESS BENEFITS FROM A PRIME LENDING RATE OF THREE PERCENT. IN GERMANY (6%), IN SWITZERLAND (6%), AND IN INDUSTRIALIZED COUNTRIES ACROSS THE GLOBE, THE FOREIGN PRIME RATE IS LOWER THAN IT IS HERE IN THE

UNITED STATES. THE BEST AMERICAN COMPANIES, MEANING CORPORATIONS SUCH AS GENERAL ELECTRIC, GENERAL MOTORS AND I.B.M., ARE THE ONLY ONES WITH THE ABILITY TO ACCESS FINANCIAL CAPITAL AT THE AMERICAN PRIME RATE. FOR COMPARISON, THAT RATE CURRENTLY STANDS AT 10 PERCENT. AS YOU CAN READILY SEE, WITHOUT FEDERAL OR STATE ASSISTANCE, EVEN THE BEST AMERICAN COMPANIES FIND THEMSELVES PLAYING ON AN UNEVEN FIELD.

IN MAINE, WHERE 98 PERCENT OF OUR BUSINESSES HAVE FEWER THAN 100 EMPLOYEES, AND WHERE MORE THAN SEVENTY-FIVE PERCENT HAVE FEWER THAN TEN EMPLOYEES, BUSINESS FINANCE IS A TREMENDOUS PROBLEM.

TODAY, MAINE SMALL BUSINESS FINDS ITSELF BORROWING MONEY TO EXPAND AT RATES OF BETWEEN TWELVE AND SIXTEEN PERCENT. THE NET RESULT IS THAT THE POTATO FARMER IN FORT KENT CAN NOT COMPETE WITH THE POTATO FARMER IN NEW BRUNSWICK, CANADA. THE LUMBER MILL IN GREENVILLE CAN NOT COMPETE WITH THE LUMBER MILLS IN GERMANY. THE SHOE MANUFACTURER IN DEXTER, CAN NOT COMPETE WITH THE SHOE MANUFACTURER IN KOREA.

BECAUSE SMALL BUSINESSES CANNOT ACQUIRE LONG-TERM DEBT AND EQUITY IN THE PUBLIC MARKETS, THEY MUST RELY ON SHORT-TERM, HIGH-COST CAPITAL FROM LOCAL COMMERCIAL BANKS. A 1983 SURVEY BY THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS, ENTITLED "SMALL BUSINESS AND CREDIT" (JULY 1984) REPORTED THAT 99 PERCENT OF THE LOANS TO SMALL BUSINESSES EXCEED THE PRIME RATE BY AN AVERAGE OF THREE PERCENTAGE POINTS. THE 1986 "STATE OF

SMALL BUSINESS" BY THE SMALL BUSINESS ADMINISTRATION REPORTS THAT SMALL BUSINESSES CONTINUE TO PAY A PREMIUM OF 2 TO 5 PERCENT, COMPARED TO LOWER RATES PAID BY LARGE BUSINESSES.

THE PROBLEM IS HIGHLIGHTED WHEN CONSIDERED IN RELATION TO THE FINANCING AVAILABLE TO COMPETITOR FIRMS ABROAD. D. BRUCE MERRIFIELD, THE ASSISTANT SECRETARY OF PRODUCTIVITY, TECHNOLOGY, AND INNOVATION AT THE DEPARTMENT OF COMMERCE STATED THAT "THE COST OF CAPITAL IN THE UNITED STATES IS TWO TO THREE TIMES HIGHER THAN IN JAPAN AND OTHER COUNTRIES." THIS COMPETITIVE BURDEN IS AT LEAST EQUAL TO THE HIGHER COSTS OF AMERICAN SALARIES.

WITH THIS IN MIND, I WOULD PROPOSE THAT THE MEMBERS OF THIS COMMITTEE SUPPORT THE EXTENSION OF THE SMALL ISSUE INDUSTRIAL DEVELOPMENT BOND PROGRAM.

UNFORTUNATELY, THE IDB PROGRAM OR MORTGAGE REVENUE BOND PROGRAM AS IT IS OTHERWISE KNOWN, HAS NOT ALWAYS BEEN USED FOR THE BEST OF PURPOSES. THE FACT THAT BURGER KING AND K-MART, AMONG OTHERS, BUILT RETAIL STORES USING THIS PROGRAM AND THE FACT THAT BASEBALL STADIUMS AND LUXURY SKYBOXES WERE ALSO CONSTRUCTED WITH THE PROCEEDS OF THESE BONDS, RESULTED IN A BLACK EYE FOR THE ENTIRE PROGRAM. I BELIEVE IT IS A CASE OF A FEW BAD APPLES SPOILING THE WHOLE BUSHEL.

TO HELP ALLEVIATE ANY POTENTIAL MISGIVINGS YOU MAY HAVE WITH THE PROGRAM, I WOULD URGE CONSIDERATION OF STRICTER GUIDELINES AND LIMITS PERTAINING TO THE TYPES OF INDUSTRY AND

GEOGRAPHIC REGIONS OF THE COUNTRY THAT CAN BENEFIT FROM THIS PROGRAM.

FOR EXAMPLE, A RURAL LUMBER MILL IN ASHLAND, MAINE, WHICH MAKES CEDAR SHINGLES SHOULD RECEIVE THE BENEFITS OF THIS PROGRAM. A SALMON HATCHERY OFF THE COAST OF EASTPORT SHOULD BENEFIT FROM THIS PROGRAM. A FOOD PROCESSING PLANT IN LIMESTONE SHOULD BENEFIT FROM THIS PROGRAM.

A 75 STORE SHOPPING MALL IN PORTLAND, SHOULD NOT.

WE MUST RECOGNIZE THE IMPORTANCE OF MANUFACTURING JOBS TO THE NATION AS A WHOLE. WE MUST ALSO RECOGNIZE THAT MANY MANUFACTURING COMPANIES FIND THEMSELVES WORKING IN MATURE INDUSTRIES. THESE MATURE INDUSTRIES ARE THE BEDROCK OF OUR NATIONAL ECONOMY AND THEY ARE THE FOUNDATION UPON WHICH AMERICA WILL COMPETE TOMORROW.

BY CONSIDERING THIS ALTERNATIVE, YOU OFFER AN IMPORTANT INCENTIVE TO BUSINESSES LOCATING IN SO-CALLED ECONOMICALLY DISTRESSED REGIONS OF THE COUNTRY. BUT ADDITIONALLY, YOU LEAVE IN TACT A PROGRAM WHICH HAS MEANT A GREAT DEAL TO NUMEROUS BUSINESSES THROUGHOUT THIS COUNTRY.

WHEN YOU, THE MEMBERS OF THE JOINT ECONOMIC COMMITTEE OF THE UNITED STATES CONGRESS, CONSIDER FUTURE LEGISLATION I WOULD URGE YOU NOT TO THINK IN TERMS OF MAINE VERSUS ARKANSAS, OR OKLAHOMA VERSUS NEW HAMPSHIRE. RATHER, I BELIEVE YOU SHOULD THINK IN TERMS OF AMERICA COMPETING AGAINST THE WORLD.

Senator **Sarbanes**. Thank you very much, Mr. Martin.

We have Ms. McClure here who is an associate of my friend, Senator Daschle, and we're very pleased that Senator Daschle has joined us and would like to say a few words before we hear from you, Ms. McClure.

Senator **Daschle**.

OPENING STATEMENT OF SENATOR DASCHLE

Senator **Daschle**. Mr. Chairman, I want to thank you and the committee for holding this hearing. South Dakota, perhaps more than many States, is very sensitive to the whole issue of rural development. The Governor has made it a very high priority.

And as we look to our future, we have to be concerned about the greatest export we have in our State, which is our youth and the possibilities that youth provide our State for our future.

No one has been more articulate and more interested in the State legislature in this issue than the senate president pro tempore, Ms. McClure. She's a 7-term State senator. She has done an outstanding job in her role as president pro tempore in dealing with many of these issues, and I'm proud to introduce her to the committee this morning and look forward to her comments.

Senator **Sarbanes**. I'll yield first to Senator Symms because he may have to depart.

OPENING STATEMENT OF SENATOR SYMMS

Senator **Symms**. Mr. Chairman, I'll make a very brief statement. I want to join with my colleagues here in welcoming all of these distinguished witnesses at this, what I consider to be a very important, hearing.

And, Mr. Chairman, you are to be commended for arranging this forum to discuss rural development prospects, a topic which I think is of national importance and of national urgency.

I'm also gratified that the chairman has continued the longstanding involvement of this committee on issues of importance to rural America.

I've had the privilege of being on this committee for 8 years. I would say to my colleagues that are the witnesses here this morning, and my experience goes back—I've worked with Bill Sims on many issues when I was on the Agriculture Committee in the House previously.

But, in the 8 years that I've been on this committee, we've had dozens of hearings and several staff studies on agriculture and rural economy that have been conducted and concluded.

And I think that we would all agree that Washington doesn't have the answers either. So we've had field hearings as well. And I'm proud to have been a part of that endeavor, which helped bring rural economic development issues to national attention.

The national attention is extremely important because rural America too often has been ignored by the urban-dominated Congress. And I read through your statement, Bill, about the defense side of being able to feed Americans in time of crisis, and I think sometimes that point is overlooked.

But, on this side issue, I wish to explore. Our Republican staff on the committee has recently completed a study which shows that rural representation in the Congress is declining and that rural representatives lag behind in seniority and chairmanships.

These factors make it difficult for rural advocates to get their message across. The staff report goes beyond the political setting and discusses ways to develop and implement rural policy.

So I commend this report to the committee and ask the chairman to give his full consideration to make it a committee print for publication and release. Also, I have attached it to this statement for the hearing record.

Today, we continue our efforts to forge successful rural development policy. And, in my estimation, the future holds much promise. We have an ambitious, talented rural work force with a strong work ethic and attitudes. We have rural communities unencumbered by congestion and crime and we offer a lifestyle preferred by most Americans.

As national polls repeatedly show, this all points to the potential for growth and development in rural America, not necessarily growth and development in agriculture endeavors but in any kind of opportunity that might be a potential for them.

What don't we have then?

For starters, we don't have a Federal Government that allocates a proportionate share of program funding to rural areas, even though need is often greater. Overall, rural areas receive about 20 percent of the Federal Government programs to serve 25 percent of the U.S. population.

A worse story is told in procurement. A survey of 15 rural States revealed that they receive only 6 percent of all Federal procurement dollars.

At a time when more competition is vital, rural industry apparently is being overlooked. And I would submit that rural businesses can compete effectively in terms of reliability, quality, delivery, and price. All they want is a chance to be considered.

So, Mr. Chairman, I want to again thank you for having this hearing and I want to thank all these distinguished witnesses for being with us this morning, and I will attend as much of this as possible, although I would say in advance that we have a meeting in the Armed Services Committee. And I want to apologize to some of the witnesses that it will be mandatory that I attend that, because we're trying to wrap up the authorization bill for the end of the year.

I want to thank all of you for being here and I will carefully look at your statements.

And, Ms. McClure, I apologize for interrupting your testimony. I look forward to hearing what you have to say.

[The study attached to Senator Symms' opening statement follows:]

THE RURAL POLITICAL ECONOMY

Change & Challenge

by

DALE JAHR

Economist
Republican Staff
Joint Economic Committee
United States Congress

September 1988

94-805 0 - 89 - 2

Contents

Introduction 1

I. RURAL AMERICA IN TRANSITION 2

II. RURAL AMERICA & THE POLITICAL SETTING 5

Rural Characteristics of the U.S. House of Representatives
  Numbers Aren't Everything
  Voting Records
  Observations about the House
Rural Characteristics of the Senate
  Seniority and Leadership in the Senate
  Senate Voting Records
  Observations about the Senate

III. DEVELOPING A NATIONAL RURAL POLICY FOR THE 1990S 16

A Comment on National Policy Trends
Rural Policy Prospects in 1988
A Rural Policy Platform
Rural Policy Parameters
Summary

IV. IMPLEMENTING RURAL POLICY: A RURAL RIGHTS ACT? 22

A Rural Rights Movement
A New Coalition for the Rural Economy

Conclusion 26

Introduction

This study focuses on three topics of importance to rural political economy, all dealing with change and its challenges. The first discusses the urban and rural characteristics of the U.S. Congress. Since the Congress is responsible for designing and implementing national policy, rural advocates can better understand its actions by understanding how "rural" fits into the political equation.

Next, rural policy is examined within the context of national policy trends. Rural America is not likely to receive treatment different from or better than any other legislative proposal. The third issue is one too-often overlooked by rural proponents: devising a strategy to place rural issues on the political agenda of the Congress.

The future portends vast social, economic, and political changes for rural America. The purpose of this study is to describe the political environment which confronts rural advocates, and to identify the boundaries within which rural policy can be developed, promoted, and adopted with some degree of success.

I

RURAL AMERICA IN TRANSITION

That rural America is undergoing social and economic change is nothing new. U.S. history documents centuries of change -- advancement -- in the rural way of life. The course of change is an evolutionary process, as people respond to the opportunities and realities of their environment.

The 1970s and '80s show three important developments in "rural evolution." First, technology is radically altering how all Americans work and live. The speed at which technical advance is applied is accelerating, thereby quickening the pace of social and economic change. The adaptation and benefits of technology are not automatically distributed uniformly by some geographic standard (nor by social or other arbitrary standards either, for that matter), implying rural America must pursue its own course as seen fit. Although technical advances often translate into expensive specialization and concentration in the workplace, rural America potentially is a prime beneficiary of the "information age" breakthroughs. The mass-use of computers and telecommunications collapses geographic barriers and links rural America anywhere in an instant.

Second, rural America is increasingly affected by events outside its borders and outside the direct control of its residents. Rural America traditionally has been insulated from factors influencing the U.S. economy, such as shifts in the business cycle, interest rates and credit availability, unemployment, and the like. Today, the rural economy is affected by the performance of the macroeconomy. More importantly, the United States today is an internationalized economy -- the principal player in an expanding global arena. In this setting, rural Americans are competing with foreign and domestic concerns alike, as well as benefiting from access to more markets.

Simultaneously, rural America is coping with an economic identity crisis. Agriculture and natural resources -- industries considered synonymous with the word "rural" -- are declining relative to total U.S. gross national product. Discovering an augmented role and purpose for the rural economy is a formidable task confronting rural advocates.

Third, at a time when rural America's political prominence is waning, the nature and scope of public policy is changing. Severe constraints now limit Federal sector initiative: seemingly intractable budget deficits, the preeminence of entitlement programs, and the natural tendency to preserve status quo priorities all have contributed to the adoption of few new programs -- urban or rural -- in the 1980s.

As competition for Federal funding has intensified, rural numbers have diminished relative to the U.S. total. Minuscule as that may seem, population shifts from country to city and from one State to another have a direct bearing on Congressional representation. The rural voice is also determined by political means -- Congressional district borders are redrawn by State political officials after each decennial census. Many factors influence the placement of these boundaries, and geographic proximity or a balanced consideration of urban and rural interests are not likely to be top priorities.

Federal programs, of course, do not implicitly guarantee success. Many programs have fallen short of well-intentioned goals, or have been successful only at tremendous cost to taxpayers and opportunity costs to society. Since the New Deal days, the Federal Government has expanded its role in the affairs of States, communities and individuals. This activism has led to a centralization of administration, a standardization of programming, a concentration of resources, a loss of oversight and accountability, and, regrettably, a lack of relevance all-too-often at the applied level. The interests of rural America, as diverse as they are decentralized, are not necessarily given utmost consideration by the Federal bureaucracy. Furthermore, rural America is largely misunderstood by policymakers unfamiliar with the heartland.

In the 1980s, States have been given more freedom and responsibility under the New Federalism approach of the Reagan Administration. The result has been innovation and application of new economic development ideas unimagined by Federal planners. This spawning of ingenuity has established programs pertinent to State and local goals and potential, increased accountability of efforts and investment, and activated grassroots involvement -- all essential ingredients for success. The debate over which level of government can govern best is not at issue, but the departure from reliance on central government has invigorated creative approaches to public policy and has reemphasized local and State responsibility in the public sector.

Certainly, States cannot perform all public functions. The Federal sector plays an indispensable role in policy formation and execution. Economic issues such as interstate commerce, regulation, industry standards of safety and environmental protection, intervention in market failure, and the provision of public goods are examples where the Federal level demonstrates advantages. The importance of U.S. world leadership and the globalization of the U.S. economy also shows the need for a strong Federal Government. These broad issues have as significant an effect on rural America as they do to the Nation.

The Federal Government also serves a crucial role as defender of freedom, liberty, and justice. Tremendous socioeconomic gains have been achieved over time, promoting the extension of human rights and economic opportunity to all. However, have the inaliable rights of rural Americans been protected? Are Federal programs equitably disbursed on the basis of need regardless of location? For that matter, are rural Americans even represented in the Congress in their due proportion? Accusatory and reactionary as these questions may appear, protecting citizens disadvantaged on the basis of *geography* can be a legitimate claim deserving rectification by government action.

The urban-rural rivalry in the Congress is timeless. Indeed, Congressmen are charged with attaining their constituents' "fair share" of Federal funding. The distribution of the Federal highway trust fund appropriations is a classic example of the battle for funding. Urban proponents complain that their State or district receives only some fraction of every dollar contributed to the fund and that they deserve greater compensation. Rural proponents are quick to point out that the lion's share of Federal highway miles are in rural areas, and that they receive only a fraction of total highway funding; therefore, the rural share of highway funding should be increased. This kind of fiscal competition keeps government honest, assuming all the players are represented fairly and abide by the same rules.

Understanding the composition and characteristics of the Congress can assist rural advocates in their policy quest. However, establishing a rural policy agenda for the 1990s is only a job half-done. A political strategy to advance, defend and accomplish it is also necessary.

II

RURAL AMERICA & THE POLITICAL SETTING

Federal policymaking is not an organized, logical exercise where issues are decided solely on the basis of merit. It is a political process where programs are created and funding is allocated through leadership, persuasion, and consensus. The legislative agenda is an arbitrary, prioritized schedule of political, social, and economic objectives sought by the leaders of the House of Representatives and the Senate.

In recent years, the political arena has not given its undivided attention to rural issues, except for enacting a costly farm program. After several years of quiet activity on rural economic issues, some progress has been made since 1986. But while rural interests have been advanced effectively, the political ante and stakes were also raised by a hefty amount. Many Federal programs are vulnerable to cutbacks or elimination. New programs being considered by the Congress are painstakingly scrutinized for their fiscal impact. In short, then, the advocates for rural policy action may have succeeded in advancing several rungs up the policy ladder, but the ladder got much longer simultaneously.

Rural issues have lost prominence for many reasons. The most obvious is the diminishing percentage of Americans residing in rural areas. In 1918, rural America accounted for one-half of all residents. Sixty years later, only one-fourth of the population was rural. Congressional apportionment among States has shifted according to population dictates, resulting in further concentration of representation in high-population areas.

The rural voice has diminished also due to the makeup and tactics of voter activists. The rise of special interest groups and other issue-specific coalitions has divided constituencies across geographic lines, making rural distinctions less relevant in the political sphere. As an example, the elderly have amassed tremendous visibility and political clout in recent years, and Congress has responded generously to their interests. However, the unique concerns of the rural elderly are secondary to the concerns of the coalition at large.

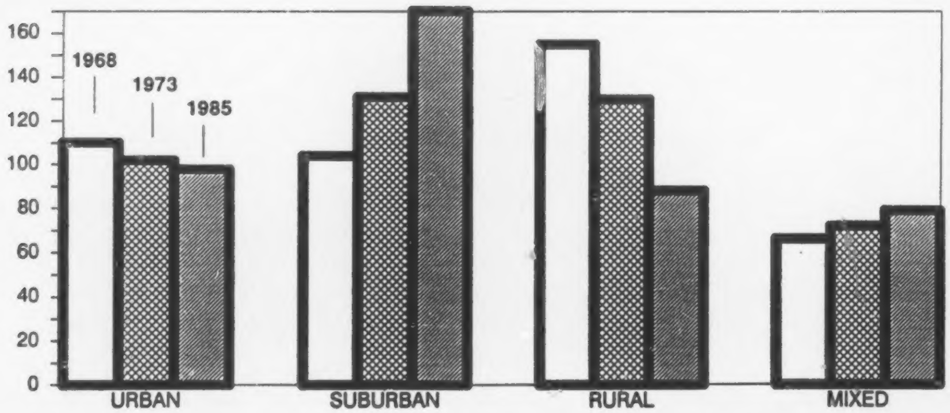
The division of constituencies by issues has resulted in an emphasis of political analysis from that perspective. While this approach is reasonable and constructive, it should not replace other legitimate points of view. Rural policy advocates could elevate their interests by presenting resourceful, comprehensive studies based on a geographic or population standpoint. A purely rural perspective of public policy and politics is overdue.

Rural Characteristics of the U.S. House of Representatives

Given the way the U.S. population is growing, it is only natural that the U.S. House of Representatives is becoming less rural. Over the past several years, this trend has accelerated. As shown in Chart II.1, rural districts were dominant in 1968, far outnumbering urban and suburban districts. That distinction changed, however, with the expansion of suburbs throughout the United States. In 1973, the number of rural and suburban districts was almost the same. Since then, rural districts vanished at about the same rate that suburban districts were formed, resulting in rural districts being at a two-to-one disadvantage by 1985.

The data presented here were outlined in an issue brief prepared by the Congressional Research Service (Huckabee, 1985). Congressional districts can be categorized as follows: "Urban" districts are those with 50 percent or more of their population residing in central

Chart II.1
DISTRIBUTION OF CONGRESSIONAL DISTRICTS
BY POPULATION CHARACTERISTICS
1968-1985

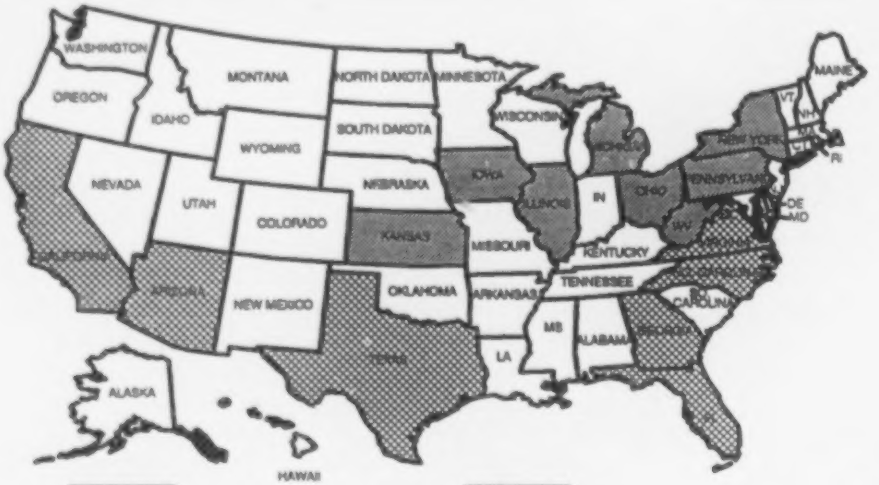


	1968	1973	1985	Percent Change 1968-73	Percent Change 1973-85
Urban Districts	110	102	98	-7.3%	-3.9%
Suburban Districts	104	131	170	26.0	29.8
Mixed Districts	66	72	79	9.1	9.7
Rural Districts	155	130	88	-16.1	-32.3

SOURCE: Congressional Research Service

cities of metropolitan areas. "Suburban" districts have half or more of the population residing outside central cities but within metropolitan areas. A "mixed" district cannot be clearly classified as urban or suburban. "Rural" districts are those where half or more of the population resides outside metropolitan areas (synonymous with "nonmetropolitan").

Chart II.2
ESTIMATED SHIFTS IN CONGRESSIONAL APPORTIONMENT AFTER 1990


WASHINGTON
OREGON
IDAHO
MONTANA
NORTH DAKOTA
MINNESOTA
MAINE
VT
NH
MA
RI
CT
WISCONSIN
SOUTH DAKOTA
WYOMING
MICHIGAN
NEW YORK
NEVADA
UTAH
NEBRASKA
IOWA
ILLINOIS
IN
OHIO
PENNSYLVANIA
DE
MD
COLORADO
KANSAS
MISSOURI
WV
KENTUCKY
CALIFORNIA
TENNESSEE
ARIZONA
NEW MEXICO
OKLAHOMA
ARKANSAS
SO CAROLINA
MS
ALABAMA
GEORGIA
TEXAS
LA
ALASKA
HAWAII

▨ **States Gaining Representation**

California	+4
Texas	+3
Florida	+3
Georgia	+1
Arizona	+1
North Carolina	+1
Virginia	+1

■ **States Losing Representation**

New York	-3
Pennsylvania	-2
Illinois	-2
Michigan	-2
Ohio	-2
Iowa	-1
Kansas	-1
West Virginia	-1

SOURCE: Congressional Research Service

Another Congressional Research Service study (Huckabee, 1987) suggests that the trend toward more metropolitan districts will continue after 1990. Based on various population projections, from 13 to 19 seats will be reapportioned to states with high population growth. That growth is occurring mostly in and around metropolitan areas. States losing seats will redraw district lines to adjust for the loss. In most instances, suburban areas will not be affected by the loss of seats; central cities and rural areas will see their boundaries expand. Chart II.2 illustrates apportionment based on a 1987 CRS analysis. With 14 seats shifting, it shows California, Texas, Florida, Georgia, Arizona, North Carolina and Virginia gaining seats. Losing representation would be New York, Pennsylvania, Illinois, Michigan, Ohio, Iowa, Kansas, and West Virginia.

A State need not lose a seat in order to lose a "rural seat." Population shifts within a State can cause district boundaries to change. Also, an increase in population density in a district can change its classification to "mixed" or "suburban" without altering its boundaries. District boundaries are not based solely on population or geographic considerations, either. State Legislatures determine the ultimate shape of a district. Known as gerrymandering, the political design of Congressional district boundaries is a practice under constant criticism and the courts may intervene in the practice. If the judicial system determines gerrymandering to be an abusive power, the impact on rural representation could be profound. Congressional districts that were based more on geographic proximity may give rural and urban residents a greater sense of common interests.

NUMBERS AREN'T EVERYTHING

If declining numbers of Rural representatives is regrettable, another aspect of the political arena reveals yet another obstacle for rural interests: seniority reigns supreme. Congressional leadership is based on seniority, and rural Members lag behind in seniority as well as numbers. According to Chart II.3, rural district Representatives on average are almost two years junior to those serving urban districts. Slight as that disparity may seem,

Chart II.3
AVERAGE NUMBER OF TERMS
U.S. House of Representatives, 100th Congress

District	All Members	Republicans	Democrats
All Districts	**5.6**	**4.8**	**6.1**
Metropolitan	5.7	5.0	6.2
Nonmetropolitan	5.3	4.7	5.7
Urban	6.3	3.8	6.8
Suburban	5.4	4.9	6.0
Mixed	5.4	5.4	5.5
Rural	5.3	4.7	5.7

NOTE: Congressional terms are two years in duration.
SOURCE: Congressional Directory and author's calculation.

it can spell the difference between controlling a Committee or Subcommittee chairmanship or not having that power. And chairmen set the agenda, call the shots, and strike the deals that result in policymaking.

While averages are helpful indicators, the critical issue at stake is how many rural Representatives are in or near top leadership positions. Rural interests do not fare well on that score. Of the House's most senior 10 percent (44 Members who have served 12 or more terms), only 6 serve rural districts. By contrast, the least senior decile (46 one-term Representatives) have 17 from rural areas.

Chart II.4
DISTRIBUTION OF HOUSE LEADERSHIP POSITIONS
By Type Of Congressional District, 100th Congress

Type of District	Committee & Subcommittee Chairmanships	Percent of Chairmanships Listed	Number of Congressional Districts	Percent of All Districts
Urban	49	32.9%	98	22.5%
Suburban	56	37.6	170	39.1
Mixed	19	12.8	79	18.2
Rural	25	16.8	88	20.2
	149	100.--	435	100.0

NOTE: Table includes 20 of 22 standing committees and their subcommittees, except those chaired by Delegates. Percentages may not add to 100 due to rounding.
SOURCE: Congressional Directory and author's calculation.

A compilation of the chairmen of 20 of the 22 standing committees (omitting the House Administration and District of Columbia Committees) and their subcommittees was prepared to determine leadership by type of district. Subcommittees chaired by Delegates were not included. The findings appear in Chart II.4. As the table shows, Representatives of urban districts control a large number of chairs relative to their numbers in the House. Suburban districts control a plurality of leadership positions close to their percentage of seats in the House. Rural districts fare unfavorably, controlling under 17 percent of the chairmanships, a smaller percentage than their share of seats in the House.

With so few rural proponents in leadership positions, rural issues are not as likely to be given full consideration. Legislation is dealt with in a political fashion, meaning more is at stake than forging public policy on the basis of merit and consensus. Political control of the legislative agenda translates into deliberate actions to favor certain constituencies and thereby endeavor to garner and guarantee future votes in elections. This is not meant as an incrimination or judgment; the very nature of our political system results in institutional behavior that serves the interests of the legislators. Nobel Laureate James M. Buchanan has elaborated on this subject in his acclaimed theory of public choice (Buchanan).

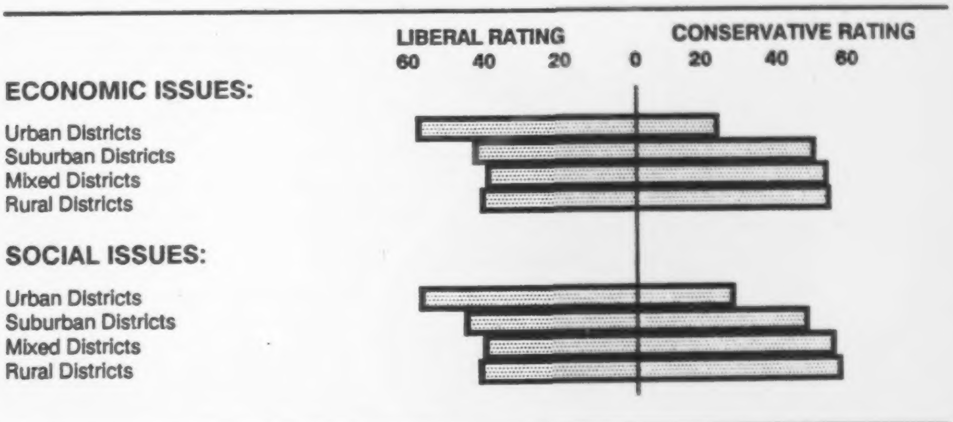
VOTING RECORDS

Using the classifications of Congressional districts described previously, voting records can be analyzed for differences between urban and rural Representatives. This study relied on 1987 ratings as compiled and published by the *National Journal* (Cohen). The findings are pronounced.

The National Journal's rating is based on key votes based on 1) type of policy issue -- economic, social or foreign (the latter is not discussed here), and 2) political nature -- liberal or conservative. Since some votes are linked to broad agendas and others contest of the ideological will or political strength of the Congress, the *National Journal* weighted votes to reflect their relative importance in the political arena. With that compilation completed, Members were then ranked according to their scores. By this scheme, a liberal rating of 60 and conservative rating of 30 does not mean a Member voted liberal 60 percent of the time and conservative 30 percent. Instead, the rating suggests that a Member is more liberal than 60 percent of the Members and more conservative than 30 percent of the House.

Two generalizations can be made about Charts II.5 and II.6. Rural Congressmen tend to be more conservative than their urban colleagues, and Rural Democrats are largely responsible for that shift. The Urban-Suburban-Mixed-Rural classification shows Representatives of urban districts to have the highest liberal and lowest conservative ratings of the Congress, for both economic and social issues. Their colleagues from rural districts posted nearly the lowest liberal ratings and the highest conservative ratings on both issues.

Chart II.5
1987 VOTING RECORD RATINGS
U.S. House of Representatives



SOURCE: National Journal and author's calculation. See Chart II.6.

Chart II.6
1987 VOTING RECORD RATINGS
By Party Affiliation and Type of Congressional District
U.S. House of Representatives

	RATING ON LIBERAL ISSUES		RATING ON CONSERVATIVE ISSUES	
	Economic	**Social**	**Economic**	**Social**
House Overall	**45**	**46**	**45**	**46**
Republicans	18	21	77	75
Democrats	64	64	23	27
Metropolitan Districts	**46**	**47**	**43**	**43**
Republicans	18	21	78	76
Democrats	65	67	20	22
Nonmetropolitan Districts	**42**	**40**	**52**	**57**
Republicans	22	23	75	74
Democrats	58	53	34	44
Urban Districts	59	60	24	28
Suburban Districts	42	45	49	46
Mixed Districts	38	39	55	56
Rural Districts	43	41	51	56

EXPLANATION: Numbers depict percentile rankings. For example, Congressmen of metropolitan districts on average are "more liberal" than 47 percent of Congress on social issues; Congressmen of nonmetro districts are "more liberal" than 40 percent on social issues, indicating they are "less liberal" than metropolitan Congressmen.
NOTE: Ratings do not average to 50 because of the weighting of votes and Members not voting on specific legislation.
SOURCE: Author's calculations based on National Journal ratings, April 2, 1988.

Both Republicans and Democrats from rural districts were more moderate than those from metropolitan districts. That is, rural Republicans had liberal ratings higher and conservative ratings lower than their metropolitan counterparts. The reverse was true for Democrats, where liberal scores were lower and conservative higher. However, Democrats deviated the most, illustrated by a jump from 22 to 44 on conservative social issues. The widest difference for Republicans was four points on liberal economic issues.

Not surprisingly, the most senior rural Representatives are more moderate than the cross-section of all rural Members. Rural Republicans with five or more terms had liberal ratings about eight points higher and conservative ratings about seven points lower than all Republicans. Rural Democrats with five or more terms had liberal scores 10 points lower and conservative measures about 17 points higher.

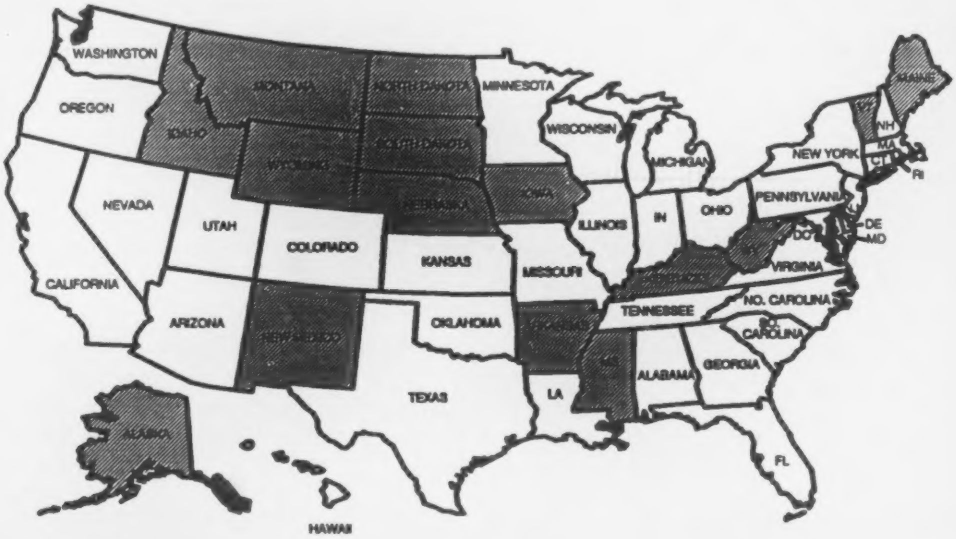
OBSERVATIONS ABOUT THE HOUSE

Rural residents, comprising about 24 percent of the U.S. population, are "under-represented" in the House. Rural districts number 88, or 20 percent, indicating that geographic representation is not uniform. In terms of seniority and leadership, rural Representatives lag behind their urban colleagues, occupying less than 17 percent of key leadership positions. If the House reflected the rural population uniformly, about 104 seats would serve rural districts, and about 36 rural Representatives would control chairs instead of the current 25.

Rural Characteristics of the U.S. Senate

Based on equal representation for every State, the Senate gives rise to political behavior and institutional practices different from the House. This distinction by and large can work in favor of rural interests, just as it does for other diverse voting blocs, such as the elderly. All States except New Jersey have nonmetropolitan areas, and even New Jersey contains areas that are rural by the familiar Census definition -- places with fewer than 2500 persons.

Chart II.7
STATES WITH A MAJORITY NONMETROPOLITAN POPULATION


WASHINGTON
OREGON
IDAHO
MONTANA
NORTH DAKOTA
MINNESOTA
WISCONSIN
MICHIGAN
NEW YORK
VT
NH
MAINE
MA
CT
RI
SOUTH DAKOTA
WYOMING
NEVADA
UTAH
NEBRASKA
IOWA
ILLINOIS
IN
OHIO
PENNSYLVANIA
DE
MD
DC
COLORADO
KANSAS
MISSOURI
VIRGINIA
CALIFORNIA
NO. CAROLINA
TENNESSEE
ARIZONA
NEW MEXICO
OKLAHOMA
SO. CAROLINA
MS
ALABAMA
GEORGIA
TEXAS
LA
ALASKA
FL
HAWAII

The 15 shaded States each have 50 percent or more of their population residing in nonmetropolitan areas.
SOURCE: Census Bureau

Senators must appeal to a much broader constituency than do Representatives. Their actions are accountable to that more diverse electorate as well.

Fifteen of the 50 States have a majority of their populations residing in nonmetropolitan areas, as shown on Chart II.7. They are Maine, Vermont, West Virginia, Kentucky, Mississippi, Arkansas, Iowa, North Dakota, South Dakota, Nebraska, Montana, Idaho, Wyoming, New Mexico, and Alaska. This nucleus of 30 Senators already shows a potentially stronger voice for rural interests than exists in the House.

Other States have circumstances which can compel Senators to act more responsively to their rural constituencies. For one matter, as shown in Chart II.8, 17 States have rural populations that are "under-represented," i.e., the proportion of rural Congressional districts is less than that indicated by the State's rural population. Of course, populations and districts are not uniformly distributed. Despite this, the illustration can be useful to enlighten Senators of the absence of complete representation and to apprise them of the need for greater attention to rural issues.

The more prominent the rural population is, the greater the validity of stressing the importance of strong rural advocacy. Chart II.8 thus lists the "under-represented" states in terms of decreasing rurality. This table contains many States considered by the public to be traditionally rural due to their geographic size or mainstay industries. Among the

Chart II.8
STATES WITH RURAL "UNDER-REPRESENTATION"
Listed in Decreasing Rural Proportionality

State	1986 Population Percent Rural	Congressional Districts Percent Rural	Number of Rural Congressional Districts	Number of Rural Seats for Proportional Representation
West Virginia	63.4%	50.0%	2	3
North Carolina	45.0	36.4	4	5
Alabama	35.9	28.6	2	3
Tennessee	33.2	22.2	2	3
Oregon	32.6	20.0	1	2
Indiana	32.0	20.0	2	3
Arizona	23.4	0	0	1
Utah	23.0	0	0	1
Michigan	19.8	16.7	3	4
Texas	19.2	14.8	4	5
Washington	19.0	0	0	2
Illinois	17.6	9.1	2	4
Pennsylvania	15.4	13.0	3	4
New York	9.5	5.9	2	3
Massachusetts	9.2	0	0	1
Florida	9.1	5.3	1	2
California	4.3	0	0	2

EXPLANATION: These 17 States have rural population proportions which exceed the proportion of Rural Congressional Districts for each State. In each case, the proportionality would be better replacing at least one metropolitan district with a rural district. States with large Congressional delegations naturally have lower thresholds to achieve better representation balance.
SOURCE: Census Bureau and author's calculations.

familiar ones are Washington, Oregon, Utah, Arizona, Illinois, Alabama, Tennessee,and North Carolina. Because of the increasing dominance of cities, however, the majority of their residents are not rural.

To be fair, two States are "over-represented" in rural terms. They are Arkansas, where three of four seats currently are rural. With a 60.7 percent rural population, two rural seats would be better reflect the State's population. The other State is Maine, whose two seats are both rural. Its 63.9 percent rural population would also suggest an even split.

Absent from this discussion are metropolitan States with substantial and vital rural interests. New Hampshire, Delaware, South Carolina, Georgia, Wisconsin, Minnesota, Louisiana, Kansas, Oklahoma, and Colorado each has either a lower population density or a rural population exceeding 30 percent of its total. These 10 States, combined with the 15 rural States form a solid nucleus to promote rural policy in the Senate.

SENIORITY AND LEADERSHIP IN THE SENATE

Unlike the House, the average seniority of Senators from rural States is not appreciably different from Senators serving metropolitan States. But important differences lie in the rural composition of the States of the most senior Senators. For the 20 highest ranking Senators, their States' populations are about 22 percent rural. The 20 least senior Senators come from States which are about 27 percent rural. Coincidentally, the Congressional Districts of these high-ranking Senators' States are about 17 percent rural, compared to 23 percent for the lowest-ranking Senators.

Senators from the 15 rural States control about 31 percent of standing Committee and Subcommittee chairmanships, nearly the same proportion as their numbers. Occupying these leadership positions helps to ensure rural advocates of a voice in a wide range of issues and policy areas.

SENATE VOTING RECORDS

As shown in Chart II.9, Senators' ratings vary significantly by party and by population characteristics of their State. On economic issues, however, the differences between metro- and nonmetro-State Senators are negligible. A spread of seven to eight points differentiates metro and nonmetro Senators on social issues.

Along party lines, nonmetro Democrats are more moderate than their metro colleagues, in contrast to nonmetro Republicans who diverge away from the norm. Nonmetro Republicans are much less liberal (by 12 points) and more conservative (by 9 points) on

Chart II.9
1987 VOTING RECORD RATINGS
By Party Affiliation and Type of State
United States Senate

	RATING ON LIBERAL ISSUES		RATING ON CONSERVATIVE ISSUES	
	Economic	Social	Economic	Social
Senate Overall	**45**	**48**	**45**	**48**
Republicans	22	27	74	70
Democrats	64	68	21	29
Metro-State Senators	**46**	**51**	**45**	**46**
Republicans	23	30	74	67
Democrats	65	69	20	28
Nonmetro-State Senators	**44**	**43**	**47**	**53**
Republicans	22	18	75	76
Democrats	63	65	22	32

EXPLANATION: Numbers depict percentile rankings. For example, Senators from metropolitan states on average are "more conservative" than 45 percent of the Senate on social issues; Senators from nonmetro states are "more conservative" than 53 percent on social issues, indicating they are "more conservative" than metro-state Senators.
NOTE: Ratings do not average to 50 because of the weighting of votes and Senators not voting on specific legislation.
SOURCE: Author's calculations based on National Journal ratings, April 2, 1988.

social issues than metro Republicans. Nonmetro Democrats move more toward the center, having an average liberal score four points lower and a conservative score four points higher than their nonmetro allies.

OBSERVATIONS ABOUT THE SENATE

While the House and Senate ratings are not directly comparable, it appears that a larger ideological gap separates Republicans and Democrats of rural States in the Senate than in the House. Both parties are responsible for that widened gap. On economic issues, Democrats seem more liberal than their House counterparts, and on social issues, Republicans are more conservative. Nonmetro States comprise a geographic and political mixture that includes populists, libertarians, conservative Southern Democrats, and Federal activists.

Rural interests are represented by a greater proportion due to the design of the Senate. In addition, since all Senators have constituents that meet a rural definition, there is just cause for their awareness of and appreciation for important rural concerns. Justification, though, is not reason enough for political prominence. Senators must see a political relevance before they advance rural issues.

III

DEVELOPING A NATIONAL RURAL POLICY FOR THE 1990s

The political pendulum swings back and forth in reaction to changes in society over time. This not only signifies a vibrant government responsive to the people, but also serves as an implicit institutional check and balance on the legislative and executive branches.

Public policy possesses a similar nature. It changes across ideological lines, advances and retreats with its results, and generally follows a path of progress according to what society considers correct. Policymakers also seek the counsel of professional public policy analysts and planners who influence both policy goals and the means to achieve them. Since people and institutions are imperfect and political science is inexact, no policy yet devised is ideal. Nor can most policy successes survive the test of time. Thus, change -- innovation, modification and reformation -- is a requisite of sound policymaking.

A Comment on National Policy Trends

Before addressing rural policy issues, a few observations about policy trends in general are in order. The 1980s policy environment has been one of transition, and one of frustration and dissatisfaction for those coping with change or having a vested interest in the status quo. Numerous government programs have been under criticism for ineffectiveness. The lackluster results of important programs in such areas as welfare and poverty have resulted in a call for wholesale reform. Deregulation, for example, has been a political movement for years, as policymakers and administrators have come to recognize that government intervention is not a blanket solution to improve society. In short, the 1980s have been a time for policy introspection where program directions and priorities have been altered in many ways.

One of the underlying, fundamental issues is forcing intense public policy debate. Its political stakes are high, for power and control of the political agenda are likely to flow to the victor. Under examination is the appropriate role of the Federal government, both in the context of the U.S. governing structure -- Federal, State, and local, and in its involvement to improve the lives of individuals.

In 1940, about 10 percent of U.S. gross national product was from the Federal Government. Last year, Uncle Sam accounted for about 22 percent of GNP. The decades-long trend of more national government has yielded slightly to New Federalism, where States have been given more flexibility. More freedom and prerogative implicitly imposed greater responsibility to the States. This transfer of authority occurred at a time of severe budget constraint, causing some Governors to complain bitterly about New Federalism. Now that the adjustment is largely over, however, most States prefer their expanded role. New Federalism's greatest accomplishment may have been the restoration of creative and innovative responses devised to address policy goals. New approaches at lower levels of government allowed States to deal with issues without rigid and sometimes unapplicable Federal guidelines which may have hindered efforts and wasted taxpayers' money.

Besides the debate over what roles and levels of government are appropriate, the *methods* of governmental actions also have come into question. Programs now require far greater justification than in the past and stricter accountability as well. Moreover, the demonstration of serious commitment on behalf of program administrators and beneficiaries, and higher matching funds and local effort point to a demand for a greater "return on public investment." Even programs for the disadvantaged now require more involvement and cooperation of the recipients themselves. The welfare reform movement now under active consideration in the Congress is testimony to this new attitude.

This brief philosophical discussion of public policy shifts and their implications gives way to a starker realization. Current Federal policy obligations exceed revenue by an unprecedented amount. Overwhelming budget deficits have paralyzed the Congress, and the stalemate is likely to continue for the next few years. Rural policymakers must take into consideration all these trends in and attitudes toward government policies and programs.

Rural Policy Prospects in 1988

Three circumstances impede the chances for new or expanded rural programs in the near future. First, many -- perhaps most -- Congressmen equate rural with farming, period. They saw $26 billion going to the farm sector last year, and $100 billion since President Reagan came to Washington. It is no secret that a growing number of elected officials are becoming very disenchanted with the skyrocketing costs of agricultural programs. That negative reaction immediately rubs off on other rural programs -- a guilt by association.

Second, the Farm Credit System has received a bailout of record proportions. Whether it costs $2 billion as hoped or more as expected, the public outlay will be remembered by disgruntled politicians for years to come, making nonfarm rural proposals difficult to promote. Third, the Farmers Home Administration, a lender of last resort, is sitting on billions of dollars of uncollectible debt for which an appropriation ultimately will be required. Again, a multibillion dollar infusion will increase political resentment against rural America.

Several rural development proposals and bills are under consideration, but none has been slated for votes for final passage in either the Senate or House. While largely status quo approaches, a number of new features are also included: the use of block grants for investment capital and infrastructure improvements, the establishment of a "Rural Fund for Development" through the Commodity Credit Corporation, a targeted emphasis on rural technology development and worker retraining, the use of "rural enterprise zones," where business is given incentives to build or expand facilities and create jobs in distressed areas, and the creation of an Assistant to the President for Agricultural and Rural Development, to name a few.

The Reagan administration, too, has implemented a six-point Rural Regeneration Initiative, which refocuses the mission of several agencies at the U.S. Department of Agriculture. This approach is one of coordination, information, technical assistance, research, education, and business capital. However, the endeavor does not include any additional funding, and instead works with the resources on hand.

A Rural Policy Platform

Beginning in 1985, the Congressional Joint Economic Committee launched a two year agenda on the rural economy, entitled *The Economic Evolution of Rural America*. Chaired by former Senator James Abdnor, Vice Chairman of the committee in the 99th Congress, this rural initiative was the first comprehensive Congressional oversight of the 1980s. He discovered a limited interest among his colleagues while he confirmed his fears about the need for attention. In the introduction to *New Dimensions in Rural Policy: Building Upon Our Heritage,* he stated, "Worsening trends in the 1980s and diminishing awareness of Washington decisionmakers toward rural issues have led me to conclude that we are 'The Forgotten America.'"

The committee outlined 25 principles of rural policy as a foundation on which successful rural programs could be launched. Here, they are condensed into 10:

> *1. There must be a renewed national commitment to rural America as human, natural resource and economic bases for generations now and to come.*
>
> *2. The positive contributions of rural America, as an integral part of the national economy, must be recognized and appreciated by Federal policymakers and all Americans. Opportunities and equal rights for rural people are as important as those of their urban counterparts.*
>
> *3. There must be a renewed commitment to the American heritage of family-owned and -operated farms as the cornerstone of our Nation's agricultural structure -- the proven and reliable provider of food and fiber at low cost for ourselves and international humanity.*
>
> *4. The natural resources of rural America -- soil, water, forests, minerals and fisheries -- must be protected and maintained as though our lives depended on them, because they do. Once taken for other uses, our farmland and natural resources can rarely be restored, and then only at great expense. For those reasons, stewardship and conservation must be practiced.*
>
> *5. Economic development efforts are best attained through teamwork. Partnerships among business, industry, government, and civic organizations can accomplish goals for job creation, diversification, and public services.*
>
> *6. Essential to rural economic development are adequate infrastructure facilities -- roads, airports, transportation systems, water treatment, fire and crime protection services, etc. Equally important are communications services, including telephones and computer links, mail and parcel delivery, and mass media, all of which provide a vital connection to the rest of the Nation.*
>
> *7. Education, health care, community, social and elderly services occupational development and recreation are central to the economic and social well being of rural Americans.*
>
> *8. Rural citizens should not be deprived of access to new technology and its benefits. These opportunities are essential to maintain equal footing with the rest of society.*
>
> *9. Rural people, households, farms, businesses, and communities have needs for social, economic, and technical information. National statistics on the conditions and changes in rural and farm populations, employment, and quality of life are needed by policymakers and planners. Research is needed on the causes and impacts of social and economic conditions in rural America.*
>
> *10. Because the rural economy is now tied directly to the U.S. economy, sound economic, fiscal, monetary, and foreign policies are imperative for long-term, stable and noninflationary growth. Policies that foster free enterprise, individual initiative, innovation, and productivity are indispensable in achieving prosperity.*

These principles present in concise fashion broad policy goals. They identify features unique to rural America; stress the importance of national awareness; underscore the need for access to technology, information, public facilities and services; recognize the urgency of private sector initiative and teamwork among all participants; and show rural America to be a part of and affected by the U.S. and world economy. This framework contains the elements of sound rural public policy. The direction of these principles is compatible with the current Federal policy environment.

Rural Policy Parameters

Numerous policy studies and analyses have been developed in response to heightened interest in the last few years. Both the setting of and policy framework for rural America have been articulated, in terms of human and capital resources, demography, and policy focus (macro, micro, sectorial, territorial, transitional, development, advocacy, etc.).

Policy proposals, of course, vary widely in scope, objective and costs. The purpose of this study is not to choose among proposals, but rather to establish a few general guidelines to smooth the bumps and minimize the snags along the policymaking path.

Effective national rural economic policy for the 1990s must evaluate and respond to three conditions: 1) rural reality, 2) Federal political and policy limitations, and 3) local involvement and commitment.

RURAL REALITY

Most policymakers do not have a clear picture of what rural America is, what it contributes to the economy, how it is affected by national economic events, and why its needs may be different from urban concerns. Rural America must prove that it is both unique and deserving of special attention. That case must be built on merit and persuasive evidence.

FEDERAL POLITICAL AND POLICY LIMITATIONS

Merit and evidence are necessary but not sufficient conditions for Congressional action. The sufficient condition is politics. Leaders must be convinced that it is in their personal and the national interest to give prominence to rural issues over others. And competition for that interest is stiff. If political requirements are satisfied, then rural policy proposals must conform to the prevailing tenor of all public policy. Today, that denotes fiscal restraint.

LOCAL INVOLVEMENT AND COMMITMENT

Regardless of the degree of Federal intervention, the crucial determinant of successful economic development and community planning is grassroots initiative. Time has shown that the Federal government is not necessarily the best motivator of people, the most efficient allocator of resources or the greatest planner for society. Policymakers now are taking steps to ensure that programs truly are desired and that the local level will strive to maximize the benefits. Federal policymakers recognize State and local commitment is an essential ingredient for achieving policy goals.

States have become valuable seedbeds of innovation. The current trend of State and local economic development activism has momentum and is demonstrating success. These efforts deserve attention and recognition, and some may emerge as models of wider application.

Summary

In the near future, there is little likelihood that any new, comprehensive, activist rural policy would be adopted at the Federal level. Regional development commissions probably will not be reborn at a time of Federal retrenchment. Rural-specific omnibus legislation is not likely to take precedence over urban-renewal bills, which have been desired for years by urban leaders. Nor can rural America expect more funding for entitlement or social programs when they have been under intense inspection for ineffectiveness and unsuitability. Washington has come to expect more in return for its appropriations.

A conventional approach to advance rural programs in a status quo environment would be to be "piggy-backed" onto some larger, costly measure that first satisfies the urban leaders of Congress. Rural advocates must realize that such a tactic could backfire. The rural allocation of large national programs easily could decline in today's political climate. The decrease in rural numbers in the Congress means even more Members will have to be persuaded to protect rural interests.

A successful new national rural policy will not beg the "What can Washington do for me?" question. Instead, a bold rural agenda will capitalize on the shift in Federal thinking already in motion. Rural policy to foster enterprise and encourage initiative -- and not just to indulge more government -- could become the model for all public policy. The Federal government plays a valuable supplemental role by ensuring that macro policy fosters growth and engenders opportunity. But grassroots leadership, innovation and follow-through will be primary determinants of rural progress.

IV

IMPLEMENTING RURAL POLICY: A RURAL RIGHTS ACT?

Advancing and enacting a rural policy is perhaps the biggest obstacle confronting rural advocates today. Agriculture is the dominant rural political force. Agricultural groups in Washington are recognized and visible, and have a history of political accomplishment. They comprise a core of support that is familiar with the gamut of rural issues. The expanded functions of the U.S. Department of Agriculture over the past several decades have made it the national focal point for most rural issues. These characteristics are desirable and beneficial.

But can agriculture continue to be the torch bearer for rural America? Only a fraction of rural counties are considered to be agriculture-dependent. In terms of employment, farming accounts for only about one in ten rural jobs. Direct and indirect employment in agriculture-related industry adds another two. Can the agricultural minority represent the others fairly and effectively? Agricultural groups have become adversaries and competitors, diminishing their reputations and leadership ability. Many politicians resent the costs associated with the past two farm bills. Furthermore, opinion is sharply divided on whether the farm program has helped or hurt the rural economy in the 1980s. Throughout history, rural America has suffered a farm/nonfarm rivalry. This polarization must cease if progress is to be made.

A Rural Rights Movement

Part of the Joint Economic Committee's *Economic Evolution of Rural America* hearings cautiously and sensitively raised the question of whether rural America was disadvantaged and discriminated against. Disadvantage was readily documented, with statistics on personal income, poverty rates, unemployment and underemployment rates, and incidence of substandard housing all showing rural America to be worse off than urban America.

The topic of discrimination is not as straightforward. Sometimes discrimination can be indirect, unintended or the consequence of ignorance. Regarding the latter cause, data collection agencies of the Federal government do not compile as much information about nonmetropolitan areas as they do for metropolitan areas. This is a deliberate decision based on budget constraints. The result, though, is a lack of information vital to rural advocacy and sound policy. Making matters worse, nonmetro data often are not collected directly but rather as a statistical residual. But residuals contain the error factors in statistical functions, resulting in less meaningful rural data.

Allocation of Federal program funds, too, reveals an urban bias. Despite the fact that nonmetro unemployment and underemployment rates exceed metro measures by a third to a half, nonmetro areas receive only about 13 percent of employment and training funds. Federal procurement programs also show a pronounced urban leaning. The 15 rural States cited earlier in this study receive only about 5.9 percent of all procurement contracts (*The 1986 Joint Economic Report*, p.198)

Another illustration of implicit Federal discrimination is the funding formula for the Job Training Partnership Act of 1982. Two-thirds of the funding was allocated according to unemployment figures of little relevance to the rural employment picture (*Is the Economic Expansion Over?* p.30). Because of under-reporting of unemployment and the way the formula was designed, rural areas were denied over $100 million in funding from 1983 through 1985, according to a preliminary analysis by the General Accounting Office.

Uncovering this evidence of bias led to a legislative proposal by committee staff. A "Rural Rights Act" was drafted, invoking familiar constitutional themes. The preamble to a "rural bill of rights" stated "...[t]hat integral and essential to the securing and maintaining of these rights is adequate *access* by all the people to public services and to the means of commerce, communication, education and health care, regardless of race sex, age, creed, national origin -- *or geographic residence.*"

This resolution followed the preamble:

> *WHEREAS, rural America is the origin and foundation of America's economic and social strength;*
>
> *WHEREAS, the Constitution of the United States and the Bill of Rights were conceived and implemented for all Americans; and*
>
> *WHEREAS, the rural and agricultural economy is undergoing a fundamental and dramatic socioeconomic transition of historical proportion;*
>
> *THEREFORE BE IT RESOLVED THAT THE CONGRESS OF THE UNITED STATES renew, strengthen and guarantee the rights of all Americans by protecting the rights of rural Americans;*
>
> *Preserve the access of rural citizens to the same basic, minimum services that are provided to urban citizens, among those being health care, education and vocational training, community services for all citizens, social services for the elderly and disadvantaged, transportation, government services to individuals and businesses, postal services, financial and commercial services, energy resources, telecommunications, and technological advances of all kinds; and*
>
> *Ensure the prosperity of all Americans by retaining and fostering the American spirit of freedom and free enterprise, goodwill, ambition, civic duty and social responsibility, as are cherished, revered and practiced by rural Americans.*

Four titles were included in the draft. The first would prohibit discrimination against rural residents. Rural citizens could not be denied participation in, or the benefits of, Federal programs or the Postal Service, or any program receiving Federal financial assistance. Of course, no one today is barred from participation *per se*; however, rural people often do not have *access* to the plethora of programs readily available in urban areas.The second required "rural impact statements" on all Federal proposals, regulations and policies to ascertain how rural areas would be affected before any action would be implemented.

The third title would create a rural rights commission. A 27-member body appointed by the President and the two bodies of Congress would examine the political, economic and social segments of rural America. Annual reports would be submitted to Congress for three years, culminating in a final report with recommendations for long-term rural policy. The fourth aspect of the proposed legislation would revamp the Department of Agriculture to strengthen and expand its role in all areas of rural society.

Such a proposal, if enacted, would greatly enhance the Federal Government's awareness of and sensitivity to rural issues. The result would be a fairer allocation of public resources to rural areas, a greater allotment of procurement contracts, equitable consideration and treatment of rural areas regarding regulations and other governmental interventions. These changes would improve the well being of rural Americans in countless ways.

A New Coalition for the Rural Economy

Coalition building is the essence of politics. Rural America is a cross-section of diverse people, groups and purposes. Uniting them in support for the rural cause would revive their visibility. Rural Americans are members of scores of politically active organizations involved with national social and economic issues. Rural members pressing for prominence of rural interests are indispensable to gain recognition. This connection must be tapped anew.

A rural coalition has many potential players from local, county and State governments, the private sector, and civic, social, religious and professional organizations. Governments have many national organizations, including the National Governors Association, the Conference of State Legislatures, the Council of State Governments, the Conference of Mayors, the Advisory Commission on Intergovernmental Relations, the National Association of Regional Councils, the National Association of Counties, the National Association of Development Organizations, the Council of State Community Affairs Agencies, the National Association of Towns and Townships.

The private sector offers the talents and resources of individual volunteers and businesses plus the clout of their national organizations. Among the major ones are the Chamber of Commerce, the National Federation of Independent Business, and the National Association of Manufacturers. Many trade-specific groups can lend assistance as well, including retail, wholesale, distribution and transportation, management, accounting, legal, and banking interests.

Public utilities are in a unique position to be involved in rural economic development. Community vitality and economic growth are essential to their continued successful operations. Recognizing a role, the National Rural Electric Cooperative Association has been very active in promoting rural issues. Telecommunications firms play a vital role in determining the potential of rural America in the information age.

Many social groups also can emphasize rural considerations, such as elderly, housing, welfare, health care and human services, and American Indian affairs. Education organizations are especially needed, given the critical and indispensable and pivotal role education and training play in the economy. Cultural organizations ranging from fine arts to historic preservation can figure prominently in establishing a unique identity for rural areas. Recreation and environmental organizations are acting to protect and preserve huge tracts of land, and therefore have a vested interest in rural America.

Enlisting the support of the abundant and diverse organizations in rural America is a means of gaining visibility and instigating cooperative efforts to advance rural issues. Endorsements can lead to the creation of an umbrella organization -- an "Alliance for Rural Progress" -- that would acquire its own identity and mission.

As an established entity, a rural coalition could engage in a national membership drive to enlist private citizens and other interested parties. Marketing and promotion -- perhaps rural America's weakest links in the 1980s -- could be a major venture of a new rural coalition. Connecting with the media and a national audience, and competing against Madison Avenue's slick and talented image makers are formidable challenges that require an carefully orchestrated, professional approach.

Coalitions work because they are comprised of dedicated participants and are responsive to their membership. They strive to impart on government the ideals they represent. They are institutions integral to our democratic process. A renewed rural coalition is essential to advance the cause for rural America.

Conclusion

Economic change is as inevitable as mankind is inventive. This penchant to innovate necessitates transition and accommodation as the new replaces the old. Rural America must adapt to a new global economic environment if it is to continue making a major contribution in the future. The economy no longer automatically "grows" in the direction of rural areas. To the contrary, ironically, our ability to provide food, fiber, natural resources, and energy in abundance has freed resources for alternative uses in alternative places. This transformation unleashed the production of goods and services unimaginable 60 years ago when the rural economy dominated the U.S. scene.

Rural America must now adopt and create new economic activities to remain integrated in, and keep pace with, the global economy. Public policy must recognize and facilitate the economic evolution transpiring within and outside rural America. Rural advocates and Federal policymakers failing to address these fundamental issues will sustain an unsatisfactory status quo -- underutilized national resources and unfulfilled personal and public opportunities.

Despite the benefits, change is also viewed as a threat to society, because it is misunderstood and disruptive. Change requires cooperation and constructive adjustment, and public policy can ease the dislocation. In his essay in *New Dimensions in Rural Policy*, Don Paarlberg considers rural America's and agriculture's transition to have parallels to the profound changes caused by the Industrial Revolution. His observations are philosophical:

> *That change, too, was poorly understood at the time. Individuals found it necessary to make difficult decisions. Traditions were swept aside. Institutions experienced stress. Politicians had to cope with problems for which they know neither cause nor solution. Unaware of the sweep of events, they addressed problems as if the old order still prevailed. There were efforts to fix blame on individuals and on groups. But the agent of change was that impersonal entity, technology. Change was resisted but it occurred nonetheless. In the effort to cope with the adverse effects of change, the great benefits thereof were overlooked and became evident only in retrospect: greater efficiency, a higher level of living and greater capability, private and public, to meet the needs of the unfortunate.*

At the turn of the century, resisting innovation and technology probably translated into a domestic forfeiture of advancement. Today, opposition to changes clearly means the forfeiture of global advantage. This escalation in opportunity costs makes sound rural policymaking all the more imperative.

References

Buchanan, James M., and Gordon Tullock. *The Calculus of Consent*. Ann Arbor: The University of Michigan Press, 1962.

Cohen, Richard E., and William Schneider. "Shift to the Left." *National Journal*, 14(1988): 873-899.

Congress of the United States. *Is the Economic Expansion Over?* A 1985 midyear review of the U.S. Economy prepared for the Joint Economic Committee, 99th Congress, 1st Session. Washington: U.S. Government Printing Office, 1985.

__________________. *New Dimensions in Rural Policy: Building Upon Our Heritage.* Studies prepared for the Joint Economic Committee, 99th Congress, 2nd Session. Washington: U.S. Government Printing Office, 1986.

__________________. *The Economic Evolution of Rural America.* Hearings before the Joint Economic Committee, Parts I and II, 99th Congress, 1st Session.Washington: U.S. Government Printing Office, 1985.

__________________. *The 1986 Joint Economic Report.* 99th Congress, 2nd Session. Washington: U.S. Government Printing Office, 1986.

__________________. "The Effect of Alternative Assumptions of Rural Unemployment Rates on Grant Allocations under the Job Training Partnership Act." Unpublished manuscript prepared for the Joint Economic Committee by the General Accounting Office, 1986.

Huckabee, David C. "Congressional Districts of the 99th Congress Classified on an Urban to Rural Continuum." Congressional Research Service Report, Library of Congress, Washington, DC, 1985.

__________________. "House Apportionment following the 1990 Census: Preliminary Projections." Congressional Research Service Report, Library of Congress, Washington, DC, 1987.

Senator **Sarbanes**. Thank you very much, Senator Symms.

I explained to the witnesses at the outset, and I believe they all understand, being fellow legislators, that we're in the closing days of the session and that the demands on our time are really very great. But, the purpose of this hearing and the symposium that the Congressional Research Service is conducting, over the next 2 days, is to assemble the record and provide the beginning of the analysis that will enable us to frame a program for coming to grips in the new Congress with what I think we all recognize as a pressing issue.

Ms. McClure, we're honored to have you here. We'd be happy to hear from you.

STATEMENT OF HON. MARY McCLURE, STATE SENATOR AND PRESIDENT PRO TEMPORE FROM SOUTH DAKOTA

Ms. **McClure**. Thank you, Mr. Chairman. It's a pleasure for me to be here and I appreciate your taking the time to discuss this very important subject that's before us.

Thank you, Senator Daschle, for your warm introduction.

We live 40 miles apart back in South Dakota. And I called Pierre this morning, Senator Daschle, and it's raining. So that was good news.

The demographics of our State are such that we have a land mass of 77,000 square miles and a population of less than 700,000. So we do, I believe, very fully fit the description of a rural State. There are an average of nine people per square mile.

In my district, which I estimate to be approximately 10,000 square miles, there are less than 20,000 people. So we aren't even average in the district that I represent of four counties.

The No. 1 industry in South Dakota, of course, is agriculture. We have 90 percent of our land in agriculture; and your charts up there are interesting to me because I have figures from 1986 showing our per capita income of $11,800, which compares with the U.S. per capita of $14,600.

Farm income as a percent of the total in 1984 was 12.1 percent in South Dakota, whereas, nationally it was 1.4 percent.

So the difference between 12 percent and 1 percent is considerable. And at that time, South Dakota reigned first among States with its dependence on rural income.

We have 80 percent of our employment in business with nine or less employees, so we're very much a small business State even for those people who are employed outside of direct farming.

All of this affects very significantly our educational programs because—just a few statistics: We have 5 percent of our school districts serving 39 percent of the students. Thirty-six percent of our school districts serve only 8 percent of our students. So we have a great many small schools; and distances, particularly in the western part of the State, are quite vast for students to travel to their schools.

My prepared statement that I have submitted deals with educational concerns in South Dakota, but I think I will use my limited time to tell you about some of the innovative programs that we have begun in South Dakota to try to help ourselves.

We have started as of last year under the Governor's initiative a program called REDI—Rural Economic Development Initiative—which is a loan program. And I think that South Dakotans were very generous in accepting it: at least we think they accepted it. We may find out in the next election.

We imposed a 1-percent sales tax for 1 year to raise $40 million for an economic development loan plan. This 1 percent sales tax was in addition to an existing 4 percent sales tax, so we had a total of 5 percent for 1 year.

Actually, it turned out to be less than 1 year by the time we were able to raise the $40 million that had been promised. And as of this legislative session in February, we removed that 1 percent sales tax.

Through that program that has only been in operation since October 1987, from October 1987 until July 1988, there had been 2,000, if we include part-time and full-time, new jobs created in South Dakota.

And we had loaned out over $8 million of that money to small businesses with the primary emphasis for receiving a loan being the creation of jobs.

These booklets explain our program in the REDI Fund, which, Mr. Chairman, you have a copy of. And also the introductory material, I have given copies to the committee for distribution.

The criteria for the lending of this money is to create jobs and to contribute to the economy of South Dakota and not to place existing South Dakota employers at a competitive disadvantage.

We feel that this program is one that will help ourselves and it has created some very innovative kinds of programs and businesses that have come into the State.

We have not yet hit every community, but the loan fund is under the jurisdiction of an economic development board. And one of the things that the board is trying to do is to bring those loan moneys into small communities and not have it all be in Souix Falls, SD.

We have the outmigration problem that you have discussed. Not only out of South Dakota but also from areas within the State.

For example, my district is experiencing a shift of population where people are going to the western part of the State and the southeastern part of the State, and we are losing population heavily in our area.

In fact, you might be interested, Senator Daschle, that recent figures we have show that every county north of Highway 34 except Codington and Brookings will be losing population in the next census and are now losing, including Brown.

So we have had quite a shift.

And one of the things that we wanted to do with this economic development loan money is to stem that tide of population shifts and to give people employment in the areas that they now live.

In connection with this program, we also have an Employer's Investment in the Future of South Dakota Fund, more concisely, Future's Fund of South Dakota, and this is money that employers have contributed through a formula very similar to the unemployment compensation tax. And these dollars are going into research and technology through our State universities and colleges.

A report that I brought along on the Future's program is a January 1988 report, so it's not as recent as it could be. But there are a number of projects listed that you might be interested in, in development of chlorine extraction technology, geothermal resources in western South Dakota, small business development center, computer cognition and these kinds of programs; one, I think particularly interesting is the research program on native grasses and another to create high-yielding mushroom compost. So we're trying to develop a diversity within our agricultural base.

Another program that we are quite excited about and we hope that we'll have the cooperation that we need, is a spinoff of the CRP or Conservation Reserve Enhancement Program, that you may be familiar with, whereby land owners set aside acres and receive payments over a 10-year period.[1]

We in South Dakota, our officials, have been working with USDA officials and Internal Revenue Service officials and expect a ruling this Friday, day after tomorrow, from the IRS on whether or not these payements could be made as up front bulk payments that would be made now in the current year, and could be considered as loans for purposes of IRS tax application.

If that ruling is favorable this Friday and we are able to channel that money to our landowners in a bulk payment up front that can be used for capital investment or for operation money, whatever is needed at this time, it will be a good influx of dollars into our economy that we could very well use.

Next Tuesday, October 4, our South Dakota officials will be meeting with USDA officials to agree on the final form and to seek a signoff. And we hope that by mid-October we'll be in the process of implementing training sessions for extension personnel to work with our landowners in setting up the program.

I suspect, Senator Daschle, that you've been heavily involved in this also and we appreciate that help. It looks as though it's coming along.

We think that South Dakota could be a flagship in this project. Missouri is looking at following in our footsteps in doing it. And North Carolina and North Dakota are also considering a similar program.

So it could be that the CRP modification will be more widespread than just South Dakota.

In education, we've been doing a number of things. I'll only mention a couple because I assume that you want to listen to many others this morning.

We are very proud that we took Dakota State College, which was a teachers institution, and transformed it into a computer center to teach technology and computer training.

We think this is an innovative step. We have also carried on a rural renaissance program where we have offered retraining to people who have been forced from the land and needed retraining for new jobs. Fifty-nine percent of those people said they were leaving the farm for economic reasons and wanted new kinds of training to go into alternative forms of employment.

---

[1] The State of South Dakota proposes to issue bonds to generate dollars for making immediate payments in full to the landowners who would then assign their 10-year payments to the State for repayment of the bonds.

We also just put on line an automated library system so that anyone from school libraries to public libraries to a rancher in the country could, if needed, by computer or telephone get complete information on any research subject.

And, finally, while our Springfield program is not strictly educational, I think it's innovative. And that is we transformed a vocational school into a prison vocational school which is working very well.

In conclusion, I think it would be out of character for a South Dakota representative or senator to come before you and not mention our need for water development money.

We continue to try to find a means to deliver water to our drought-stricken areas and we have formed a Missouri River cost recovery authority that we hope will come to Congress with a proposal. We do appreciate what assistance we received in the past, but our State is a dry one and we feel that we have water projects that are a long time overdue, since the 1944 Flood Control Act, which promised us water projects in return for a half million acres of land lost to the dam projects—not the damned projects, but the dam projects—on the Missouri River. [Laughter.]

And we thank you very much for this opportunity to testify.

[The prepared statement of Ms. McClure, together with attachments, follows:]

PREPARED STATEMENT OF HON. MARY McCLURE

SOUTH DAKOTA IS SIMILAR TO THE OTHER RURAL STATES IN THE UPPER MIDWEST, SUCH AS NORTH DAKOTA, WYOMING, NEBRASKA, MONTANA THAT ARE RURAL, HEAVILY DEPENDENT ON AGRICULTURE, EXPERIENCING EITHER SLOW POPULATION GROWTH OR DECLINING POPULATIONS AND THAT HAVE AN AGING POPULATION. ALL OF THESE FACTORS HAVE A NEGATIVE EFFECT ON THE RURAL ECONOMY.

TO APPRECIATE THE RURALNESS OF SOUTH DAKOTA, IT MAY BE HELPFUL TO LOOK AT THE ELEMENTARY AND SECONDARY SCHOOL SYSTEMS THAT SERVE THE STATE. SOUTH DAKOTA HAS 193 SCHOOL DISTRICTS OFFERING KINDERGARTEN THROUGH HIGH SCHOOL PROGRAMS. WITHIN THOSE SCHOOL DISTRICTS WE STILL HAVE 142 ONE OR TWO TEACHER ELEMENTARY SCHOOLS. OF THE 193 SCHOOL DISTRICTS, THERE ARE ONLY 27 SCHOOL DISTRICTS WITH A TOTAL K THROUGH 12 ENROLLMENT OF 801 STUDENTS OR MORE, 51 SCHOOL DISTRICTS WITH A TOTAL ENROLLMENT OF 351 TO 800, AND 115 SCHOOL DISTRICTS WITH A K THROUGH 12 ENROLLMENT OF 350 OR LESS. THE STATE HAS APPROXIMATELY 103 FOUR-YEAR HIGH SCHOOLS WITH ENROLLMENTS OF LESS THAN 100 STUDENTS.

THESE ENROLLMENT FIGURES REFLECT THE DECLINE IN THE AGRICULTURAL ECONOMY AND THE OUT-MIGRATION OF FAMILIES FROM THE RURAL AREAS TO THE URBAN AREAS.

JUST AS THE COUNTRY IS EXPERIENCING A BI-COASTAL ECONOMIC BOOM ON THE EAST AND WEST COASTS WITH THE HEARTLANDS SUFFERING ECONOMIC HARDSHIPS, SOUTH DAKOTA HAS ITS OWN VERSION OF THIS PHENOMENON. THE POPULATION IS SHIFTING FROM THE RURAL MIDDLE OF THE STATE TO THE EXTREME EASTERN AND WESTERN BORDERS OF THE STATE AROUND THE CITIES OF SIOUX FALLS AND RAPID CITY. SIOUX FALLS NOW HAS ONE-SEVENTH OF THE STATE'S POPULATION, BUT IT IS BARELY AN URBAN AREA BY NATIONAL STANDARDS. THE SHIFT CAN BE EXPLAINED IN PART BY THE GROWTH OF THE SERVICE AND TECHNOLOGY INDUSTRIES IN THOSE CITIES AND THE DECLINE IN AGRICULTURAL ECONOMY.

AGRICULTURE HAS BEEN THE TRADITIONAL INDUSTRY FOR SOUTH DAKOTA, BUT EACH YEAR IT EMPLOYS FEWER PEOPLE DUE TO BANKRUPTCIES AND POOR ECONOMIC CONDITIONS, MECHANIZATION, AND THE CREATION OF LARGER FARMS. SOUTH DAKOTA IS TRYING TO IMPROVE ITS ECONOMY THROUGH DIVERSIFICATION BY BECOMING LESS DEPENDENT ON PRODUCTION AGRICULTURE.

EDUCATION IS AN IMPORTANT FACTOR IN HELPING THE STATE DIVERSIFY ITS ECONOMY. FIRST, YOU NEED A STRONG ELEMENTARY AND SECONDARY EDUCATIONAL SYSTEM THAT PROVIDES A LITERATE WORKFORCE THAT WILL BE ABLE TO EVOLVE WITH THE CHANGING ECONOMY. SECOND, YOU NEED A STRONG VOCATIONAL EDUCATION SYSTEM THAT CAN TRAIN PEOPLE TO APPLY EXISTING AND NEW TECHNOLOGIES IN BUSINESS AND INDUSTRY AND A VOCATIONAL SYSTEM THAT CAN RETRAIN THE PEOPLE THAT LEAVE SHRINKING OR ECONOMICALLY DEPRESSED INDUSTRIES LIKE AGRICULTURE. THIRD, YOU NEED A STRONG HIGHER EDUCATIONAL SYSTEM THAT WILL HELP THE EXISTING SECTORS OF THE STATE'S ECONOMY GROW AND BECOME MORE EFFICIENT AND PROVIDE RESEARCH AND DEVELOPMENT FOR NEW TECHNOLOGIES AND APPLIED RESEARCH TO EXISTING TECHNOLOGIES.

LAST YEAR, UNDER THE RURAL EDUCATION ASSISTANCE PROGRAM, A PRELIMINARY SURVEY REVEALED THAT APPROXIMATELY 56% OF THAT PROGRAM'S PARTICIPANTS LEFT THE FARM DUE TO ECONOMIC CONDITIONS; 39% CONTINUED TO FARM BUT WANTED TO SUPPLEMENT THEIR INCOME; AND 5% WERE FARM LABORERS WHO SOUGHT RETRAINING DUE TO THEIR EMPLOYER'S ECONOMIC PROBLEMS. THESE PEOPLE WERE ATTENDING VOCATIONAL SCHOOLS, COLLEGES AND UNIVERSITIES, AND COMMUNITY COLLEGES, SEEKING TRAINING IN AGRI-BUSINESS, ACCOUNTING, MEDICAL FIELDS, COMPUTERS AND ENGINEERING, PLUMBING, WELDING, SECRETARIAL, DRAFTING AND COSMETOLOGY.

THE EDUCATIONAL ASSISTANCE WAS PART OF A LARGER "RURAL RENAISSANCE" PROGRAM WHICH WAS IMPLEMENTED IN RESPONSE TO THE FARM ECONOMY CRISIS. THE PROGRAM

PROVIDED FINANCIAL ASSISTANCE FOR THOSE FARMERS AND RANCHERS WHO WANTED TO OBTAIN THE MARKETABLE SKILLS NECESSARY TO SUPPLEMENT THEIR FARM INCOME OR TO BE EMPLOYED IN OTHER JOBS. ELIGIBILITY FOR THE PROGRAM WAS BASED ON FARM INCOME, A PERSON'S DEBT-TO-ASSET RATIO, AGE, AND LACK OF CURRENT OFF-FARM EMPLOYMENT. THE ELIGIBLE PARTICIPANTS RECEIVED A BI-MONTHLY STIPEND TO HELP MEET EXPENSES OF UP TO $300 PER MONTH, AND FLAT GRANTS OF $100 FOR FEES, AND $300 FOR BOOKS AND MATERIALS. A PERSON COULD BE ELIGIBLE FOR ASSISTANCE FOR TWO YEARS, WITH THE AVERAGE PARTICIPANT STAYING IN THE PROGRAM FOR 18 MONTHS AND COSTING $4,800.

IN 1984, SOUTH DAKOTA TOOK TWO BOLD AND CONTROVERSIAL STEPS TO STRENGTHEN ITS HIGHER EDUCATIONAL SYSTEM. THE MOST SIGNIFICANT WAS THE CONVERSION OF THE UNIVERSITY OF SOUTH DAKOTA AT SPRINGFIELD FROM A POST-SECONDARY VOCATIONAL SCHOOL INTO A MINIMUM SECURITY PRISON. THE EXISTING STATE PENITENTIARY WAS OLD, OVERCROWDED AND FACING A FEDERAL LAWSUIT REGARDING PRISON CONDITIONS. THE STATE WAS SUPPORTING SEVEN PUBLIC INSTITUTIONS OF HIGHER EDUCATION, THEREBY SPREADING THE ALREADY SCARCE HIGHER EDUCATIONAL DOLLAR AMONG TOO MANY EDUCATIONAL INSTITUTIONS. THE GOVERNOR PROPOSED TO TURN USD/SPRINGFIELD INTO AN ACCREDITED CO-CORRECTIONAL VOCATIONAL EDUCATION FACILITY TO SERVE BOTH MEN AND WOMEN INMATES. THE GOVERNOR SOLD THE PROGRAM, AFTER A LEGISLATIVE BLOOD BATH, ON THE THEORY THAT IT IS BETTER TO EDUCATE THE INMATES AND GIVE THEM A MARKETABLE SKILL RATHER THAN TO MERELY HOLD THEM IN PRISON. THE CONVERSION OF THE SCHOOL INTO A MINIMUM SECURITY PRISON ALLOWED THE STATE TO RELIEVE ITS PRISON OVERCROWDING, PROVIDE TRAINING FOR THE INMATES, AND TO RELIEVE THE STRAIN ON ITS HIGHER EDUCATION DOLLAR.

THE SECOND STEP, LESS CONTROVERSIAL BUT JUST AS BOLD, WAS THE CHANGE IN THE MISSION OF DAKOTA STATE COLLEGE FROM A TEACHERS SCHOOL INTO A HIGH-TECH

CENTER EMPHASIZING INSTRUCTION IN COMPUTER MANAGEMENT, COMPUTER INFORMATION SYSTEMS, ELECTRONIC DATA PROCESSING, AND OTHER RELATED UNDERGRADUATE AND GRADUATE PROGRAMS. THIS CHANGE WAS ACCOMPLISHED IN PART WITH THE COOPERATION AND INPUT OF PRIVATE INDUSTRY WHEN CITIBANK, AN EMPLOYER OF THIS TYPE OF HIGH-TECH STUDENT, LOANED ONE OF ITS EXECUTIVES TO ASSIST THE SCHOOL DURING ITS TRANSITION. THE MISSION CHANGE HAS SPAWNED SOME COMPUTER SOFTWARE DEVELOPERS, AND THE SCHOOL RECENTLY RECEIVED NATIONAL HONORS IN RECOGNITION OF ITS INNOVATIVE USE OF COMPUTERS IN THE CLASSROOM.

ANOTHER EDUCATIONAL INNOVATION WHICH MAY HELP TO IMPROVE THE RURAL ECONOMY IS THE DEVELOPMENT OF THE SOUTH DAKOTA LIBRARY NETWORK. THIS SYSTEM PROVIDES ON-LINE PUBLIC ACCESS VIA MICROCOMPUTER AND TELEPHONE LINES TO 15 LIBRARIES AROUND THE STATE, INCLUDING 10 STATE-RUN LIBRARIES. THE NETWORK WILL GREATLY FACILITATE ACCESS TO INFORMATION AND WILL HAVE THE EFFECT OF EXPANDING A SINGLE LIBRARY'S HOLDINGS TO INCLUDE THE COLLECTIONS OF ALL THE PARTICIPATING LIBRARIES AND REDUCE COSTS.

ALL OF THIS TAKES TAX DOLLARS.

THERE IS A DYNAMIC TENSION BETWEEN EDUCATION AND ECONOMIC DEVELOPMENT AND HOW EACH VIEWS TAXATION. EDUCATION AT THE ELEMENTARY AND SECONDARY SCHOOL LEVEL IS THE LARGEST CONSUMER OF LOCALLY-RAISED PROPERTY TAX DOLLARS. HIGH PROPERTY TAXES CAN BE A DISINCENTIVE FOR BUSINESS AND ECONOMIC DEVELOPMENT. GENERALLY, WHEN COMMUNITIES SEEK TO ATTRACT NEW BUSINESS ONE OF THE INCENTIVES TO LOCATE IN A GIVEN AREA ARE TAX BREAKS. UNFORTUNATELY, IF INDUSTRY IS GIVEN A PROPERTY TAX BREAK, THE COMMUNITY ERODES ITS ABILITY TO FUND EDUCATION. A STRONG EDUCATIONAL SYSTEM IS AN INFRASTRUCTURE INVESTMENT THAT THE PUBLIC WANTS, BUSINESS AND INDUSTRY WANT AND IS A FACTOR THAT WILL ENHANCE THE POSSIBILITY FOR FUTURE ECONOMIC DEVELOPMENT.

ON A MORE BASIC LEVEL, EDUCATION HAS A DIRECT IMPACT UPON A RURAL ECONOMY BECAUSE IN MANY RURAL AREAS THE SCHOOL DISTRICT IS THE LARGEST EMPLOYER FOR THE AREA, AND IT IS ALSO THE LARGEST SPENDER OF TAX DOLLARS. THE LOSS OF A SCHOOL AND THE ECONOMIC POWER OF ITS EMPLOYEES' SALARIES CAN DEVASTATE A SMALL COMMUNITY. WITHIN THIS CONTEXT, THE SALARIES AND BENEFITS PAID TO SCHOOL DISTRICT EMPLOYEES ACCOUNT FOR APPROXIMATELY 75% OF A SCHOOL DISTRICT'S BUDGET. EVEN WITH THIS LARGE PERCENTAGE OF THE BUDGET CONSUMED BY SALARIES, THE AVERAGE PAY FOR TEACHERS IN SOUTH DAKOTA IS LOW. THE AVERAGE PAY FOR TEACHERS IN THE STATE RANKS 51ST WHEN COMPARED TO THE OTHER STATES AND THE DISTRICT OF COLUMBIA. WITH THE OUT-MIGRATION AND AGING OF THE STATE'S RURAL POPULATION, THERE WILL BE MORE LOW ENROLLMENT SCHOOL DISTRICTS WHICH WILL EVENTUALLY BE FORCED TO CONSOLIDATE WITH THEIR NEIGHBORING SCHOOL DISTRICTS, RESULTING IN FEWER SCHOOL DISTRICTS.

IN 1985, ONE PROGRAM THAT WAS ATTEMPTED IN SOUTH DAKOTA TO IMPROVE SECONDARY EDUCATION WAS THE "FAMILY OPTION." IT WAS VERY SIMILAR TO THE RECENTLY IMPLEMENTED "CHOOSE A SCHOOL" PROGRAM IN MINNESOTA. UNDER THIS PROGRAM, PROPOSED BY FORMER GOVERNOR JANKLOW, THE STATE WOULD ALLOW A STUDENT ATTENDING A HIGH SCHOOL WITH AN ENROLLMENT OF LESS THAN FORTY-FIVE STUDENTS TO TRANSFER TO ANY CONTIGUOUS SCHOOL DISTRICT WITH AN ENROLLMENT OF MORE THAN FORTY-FIVE STUDENTS. THE TRANSFERRING STUDENT WAS ENTITLED TO TUITION ASSISTANCE FROM HIS SCHOOL DISTRICT OF RESIDENCE THROUGHOUT HIS HIGH SCHOOL CAREER. THE CHOICE TO IMPLEMENT THIS PROGRAM WAS VESTED IN THE PARENTS OR GUARDIAN OF THE STUDENT AND WAS EXERCISED BY GIVING WRITTEN NOTICE TO THE SUPERINTENDENT OF ELEMENTARY AND SECONDARY EDUCATION BY AUGUST 15 PRECEDING THE SCHOOL TERM.

UNFORTUNATELY, THIS PROGRAM WAS NEVER IMPLEMENTED BECAUSE, UNDER A STATE CONSTITUTIONAL PROVISION ALLOWING CITIZENS TO REFER UNPOPULAR LEGISLATIVE

ENACTMENTS TO A VOTE AT THE NEXT GENERAL ELECTION, THE CITIZENS OPPOSED TO THE "FAMILY OPTION" WERE ABLE TO OBTAIN ENOUGH SIGNATURES TO HAVE THIS LEGISLATIVE MEASURE REFERRED TO A VOTE OF THE PEOPLE. THE REFERRAL SUSPENDED THE IMPLEMENTATION OF THE ACT IN 1985, AND BEFORE THE VOTE COULD BE TAKEN IN NOVEMBER OF 1986, THE LEGISLATURE REPEALED IT.

IN 1987, GOVERNOR MICKELSON MOVED AGGRESSIVELY TO IMPROVE THE ECONOMIC CONDITIONS IN SOUTH DAKOTA WHEN HE PROPOSED A THREE-PART PLAN FOR ECONOMIC DEVELOPMENT. FIRST, HE REORGANIZED THE GOVERNOR'S OFFICE OF ECONOMIC DEVELOPMENT. SECOND, HE PROPOSED THAT THE STATE INCREASE ITS SALES TAX BY ONE-CENT FOR ONE YEAR TO PROVIDE APPROXIMATELY $40 MILLION TO FUND THE ECONOMIC DEVELOPMENT LOAN SPECIAL REVENUE FUND". THIRD, HE PROPOSED THE CREATION OF THE EMPLOYER'S INVESTMENT IN SOUTH DAKOTA'S FUTURE SPECIAL REVENUE FUND WHICH WAS FUNDED BY USING A TAXING MECHANISM SIMILAR TO THE TAX PAID BY EMPLOYERS INTO THE UNEMPLOYMENT COMPENSATION FUND.

THE "ECONOMIC DEVELOPMENT LOAN SPECIAL REVENUE FUND," ALSO KNOWN AS THE "REDI" FUND, PROVIDED THE MONEY FOR LOANS TO BUSINESS ON A ONE-TO-ONE MATCHING BASIS, THEN, THROUGH THE USE OF THE STATE'S VENTURE CAPITAL FUND, COMMUNITY DEVELOPMENT BLOCK GRANT MONEY OR OTHER MATCHING REQUIREMENTS, THE TOTAL AVAILABLE FOR ECONOMIC DEVELOPMENT WAS INCREASED TO APPROXIMATELY $116 MILLION. THE FUND IS ADMINISTERED BY THE BOARD OF ECONOMIC DEVELOPMENT, APPOINTED BY THE GOVERNOR, WHICH ESTABLISHES THE CRITERIA FOR THE QUALIFICATION, APPLICATION, PAYMENT AND REPAYMENT OF THE FUNDS FOR ANY LOANS THAT ARE APPROVED BY THE BOARD.

IN THE FIRST YEAR OF OPERATION OF THE LOAN PROGRAM, THE BOARD HAS BEEN SUCCESSFUL IN ATTRACTING NEW BUSINESS TO THE STATE AND HELPING EXISTING BUSINESSES EXPAND. THE BOARD HAS MADE LOANS TO BUSINESSES, SUCH AS A

HIGH-TECH COMPUTER HARDWARE MANUFACTURER, INDUSTRIAL TRAILER MANUFACTURER, AND LIVESTOCK PROCESSORS.

THE FUTURE'S FUND WAS ESTABLISHED TO ATTRACT RESEARCH PROJECTS TO THE STATE. THIS SPECIAL FUND IS USED TO MAKE GRANTS TO COLLEGES AND UNIVERSITIES FOR PURPOSES RELATED TO RESEARCH AND ECONOMIC DEVELOPMENT.

INVESTMENT IN EDUCATION IS A KEY TO IMPROVING A STATE'S ECONOMY THROUGH THE IMPROVEMENT OF THE ELEMENTARY AND SECONDARY EDUCATIONAL SYSTEM, SO THAT THE STUDENTS PRODUCED BY THE SYSTEM CAN COMPETE, THROUGH FLEXIBLE POST-SECONDARY VOCATIONAL EDUCATION FOR TRAINING NEW EMPLOYEES OR RE-TRAINING WORKERS FOR NEW INDUSTRIES AND THROUGH INVESTMENT IN HIGHER EDUCATION FOR BASIC RESEARCH INTO NEW AREAS AND APPLIED RESEARCH FINDING NEW USES FOR EXISTING TECHNOLOGY.

South Dakota
BOARD of ECONOMIC DEVELOPMENT
Annual Report

to

Governor George S. Mickelson

and the

Members of the South Dakota Legislature

September 1, 1988

Governor's Office of Economic Development
Capitol Lake Plaza
Pierre, South Dakota 57501
605-773-5032

REDI Fund

MEMORANDUM **September 1, 1988**

TO: Governor George S. Mickelson
Members of the South Dakota Legislature

FROM: Board of Economic Development

RE: Annual Report by Board of Economic Development

SDCL 1-42-27 states, "The Board of Economic Development shall prepare an annual report by the first day of September of each year detailing the activities of the board and the terms and conditions of any loans made, including the current status of outstanding loans."

SDCL 1-33-25 requires that the Business Recruitment Council submit an annual action plan "to the board of economic development for approval prior to July first of each state fiscal year. At the conclusion of each fiscal year, the council shall prepare, or cause to have prepared, and submit an annual report to the board of economic development.

SDCL 1-16B-50 requires the South Dakota economic development finance authority to "develop and submit an annual action plan to the board of economic development. The action plan shall outline the basic goals and objectives of the authority but is not subject to the approval or disapproval of the board of economic development. The action plan shall be submitted prior to July first of each state fiscal year. At the conclusion of each fiscal year, the authority shall prepare, or cause to be prepared, and submit an annual informational report to the board of economic development."

SDCL 1-42-15.2 requires that "The South Dakota Development corporation, created in Executive Order 83-12, shall submit its annual action plan to the board of economic development for approval or disapproval. The action plan shall outline the basic goals and objectives of the corporation and shall be submitted prior to July first of each state fiscal year. At the conclusion of each fiscal year, the corporation shall prepare, or cause to be prepared, and submit an annual report to the board of economic development."

In accordance with the law, we respectfully submit the Annual Report of the Board of Economic Development. The reports of the Finance Authority, Development Corporation, and the Business Recruitment Council are under a separate cover.

REVOLVING ECONOMIC DEVELOPMENT & INITIATIVE FUND

ANNUAL REPORT

TABLE OF CONTENTS

I. REPORT OF THE BOARD OF ECONOMIC DEVELOPMENT

Section A: The REDI Fund Program

- Introduction
- Mission of the REDI Fund
- Lending
- Factors for Consideration and Approval
- Applications Considered and Pending as of July 1, 1988
- Application Process
- Restrictive Covenants

Section B: Economic Development Accomplishments

- Comparison FY 1987 & 1988 Loan Activity in GOED
- Job Creation
- Increased Income
- Diversification
- Capital Investment
- Distribution of Funds
- Agriculture Processing
- Creative Financial Packaging
- Technical Innovation

Section C: Loan Portfolio

- REDI Loan Summary Sheet
- REDI Fund Borrowers
- Current Loan Status

Section D: Statements of Auditing

- Banking Commission
- Legislative Audit

Section E: The Operation of the REDI Fund

- Board Members
- Staff

Section F: Miscellaneous

- Definitions
- Sources of Economic Analysis

SECTION A: THE REDI FUND PROGRAM

INTRODUCTION

On the opening day of the 1987 legislature, Governor George S. Mickelson urged South Dakota legislators to make a major commitment to economic development and South Dakota's future. Economic development is a process that depends on our ability to take advantage of opportunities and nurture them to success. Economic development doesn't happen overnight. It is a long arduous journey that depends on dedication, patience, coordination and courage.

To consult with and advise the Governor and his Commissioner of the Office of Economic Development, the Governor created the Board of Economic Development. The 13 member Board of Economic Development also administers the Revolving Economic Development & Initiative Fund. The REDI Fund is a $40 million revolving loan fund that provides South Dakotans the resources necessary to assist companies create quality job opportunities into the 21st century.

All members of the Board of Economic Development are very proud of the REDI Fund's progress thus far. In April of 1987, we embarked on a mission that had never been attempted. Since that time we have made a significant impact on our state's ability to employ South Dakotans. We sincerely appreciate the support and cooperation that has been provided by the local development representatives, our state's banks, and especially, the taxpayers of South Dakota. We are very humbled and honored by the trust you have placed in us, and we take it very seriously. We will keep working for the economic future of our state and its people.

South Dakota has a favorable business climate and Governor Mickelson is committed to maintaining the state's present regulatory and taxation climate. South Dakota continues to be rated highly as a good place to do business. This year we were selected by Grant Thornton (a national management consulting firm) as the state with the "Best Manufacturing Climate" for light manufacturing.

When Hutchinson Technology announced its expansion in Sioux Falls, CEO Jeff Green said they chose Sioux Falls because of the "availability of labor, the more favorable business climate and the incentives offered by the state and local officials.

The Governor's commitment to education insures that we will continue to provide the quality of employees that companies will need in the future. Governor Mickelson firmly believes our education system is directly related to our future economic development success. Economic development in South Dakota must be built on a firm foundation -- a foundation that begins with well-trained, fairly paid teachers and ends with well-educated high school, vocational and college graduates who can find satisfying work in South Dakota.

Education is crucial to economic success. Through the use of the Future Fund, also created in 1987, Governor Mickelson strongly supports partnerships with vocational schools, colleges, universities and industry to move our state forward. Institutions of higher learning must communicate and cooperate with business if graduates are to have the skills demanded in the workplace. A strong educational system producing well-trained graduates will attract businesses that can provide challenging employment for South Dakota graduates.

Governor Mickelson's management style encourages all departments of state government to consider the implication of their programs on the future development of South Dakota. After he was elected, the Governor created subcabinet groups which consist of cabinet members with interests that cross department lines. For example, the Water and Natural Resources subcabinet group consists of the Secretaries of Economic Development, Water and Natural Resources, Tourism, Game Fish & Parks, Transportation, Agriculture and Military and Veterans Affairs.

These subcabinet groups, which meet regularly to increase communication between departments, increase efficiency and decrease duplication. GOED Commissioner Ron Reed serves on several subcabinet groups with the purpose of communicating the impact on economic development as well as becoming aware of the concerns of other departments.

MISSION OF THE REDI FUND

The REDI Fund is the state's primary financial incentive to encourage companies to move to South Dakota. It also provides an incentive for companies to expand their present operations within the state, or to start new companies with the express purpose of creating quality job opportunities and reversing the exodus of our young people.

Economic development depends on growth and innovation. Growth and innovation are very expensive and difficult to finance and there never is enough money to grow as fast as businesses would like. Rather than being the lender of last resort, we use the REDI Fund's low-interest rate and long amortization period to help the business grow, create new jobs, increase sales, and build capital through cash flow. Each of our borrowers has the realistic probability of high growth in the next five years.

The REDI Fund and Board of Economic Development were not created or supported by the people of South Dakota to provide financing for people to get into business. The Small Business Administration fulfills this need effectively. In 1987, the South Dakota SBA District office approved loans to 269 businesses that totaled over $38,000,000. These loans will create 754 new jobs and retain 1,927 jobs for a total of 2,681. We applaud and support the efforts of the SBA in South Dakota and want to continue to complement this program, not duplicate it.

The primary mission of the REDI Fund is to create incentives for the creation of new quality job opportunities in South Dakota. Although we have made loans of substantial risk, we hesitate to be the lender of last resort because of the high probability of failure. We are in the job creation business, we do not want to finance businesses and jobs that are doomed to fail from the beginning. Creating jobs that have such a degree of risk are not of the quality that fulfills the REDI Fund mission.

A $200,000 REDI Fund loan versus traditional financing would save a company $28,000 per year annual debt service. This savings can be used by the business:

1) to cut prices or expand advertising which will increase the demand for their product and the need for employees;
2) to use for employee training;
3) to cushion risk in a business expansion; and
4) as an incentive to stay in or move to South Dakota, which gives us a competitive edge in job creation;

The successes of the REDI Fund are obvious:

1) Paramount Technical Products, who moved to South Dakota in January, used its savings to self-finance an expansion of its new manufacturing plant;
2) Veblen Cheese will use its savings to cut costs, increase market demand for its cheese, and stabilize its long-term demand for area dairy farmer's milk;
3) The long-range expansion plan of Larson Manufacturing was speeded up because of the favorable financing of the REDI Fund;
4) Wildcat Manufacturing now has the cash flow to purchase an established product line from a Georgia company that complements the existing product line; and the list goes on.

LENDING

Some people have stated that we need to get the $40 million loaned out faster and not be selective. In many cases, these are the same people who have said we are loaning the funds to companies that don't need it. The question is, if we imprudently lend to companies with ill-conceived ideas or products, will South Dakota be better off in five years when both the money and the jobs are gone? The REDI Fund is a loan program, not a grant program.

The best business ideas are not all going to come in 1988 or 1989. In fact, many businesses take months or years to make the decision to relocate or expand. GOED is often contacted by prospective businesses in the planning stage of the project. The REDI Fund does make a difference in a decision to expand or relocate. Many businesses look long and hard at the costs of an expansion and the potential profit before making a decision. The REDI Fund's low interest rate and long amortization period reduces cash demands during the early stages of a start-up or business expansion and greatly reduces the stress of expanding.

For example, for over ten months the Office of Economic Development has been working with two companies who have submitted applications totaling over $1.5 million and the creation of 350 jobs, but the companies have not yet decided whether or not to go ahead with the projects.

The first 33 loans will balloon after November of 1992 and annual debt service payments will be less than $3 million per year after the entire fund is lent out. If the Board were to lend all the money within the first couple of years, the REDI Fund would not be available as an incentive to assist business ideas in 1990. To lend the money at a constant amount until the balloon payments become due (assuming there were no loan defaults), the Board would have to approve loans averaging $825,000 per month. In the first ten months of operation, the REDI Fund has approved an average of $850,000 per month.

FACTORS FOR CONSIDERATION AND APPROVAL

Besides factors for approval required by law, the Board of Economic Development approves loans to businesses which:

1) will create quality primary jobs,
2) have a reasonable prospect the business and jobs will succeed,
3) will contribute to the economy of South Dakota,
4) REDI Fund participation is proportionate to that benefit, and
5) will not place existing South Dakota employers at a competitive disadvantage.

APPLICATIONS CONSIDERED AND PENDING AS OF JULY 1, 1988

As of June 30, the Board of Economic Development has considered 56 full applications. Of these, thirty-three were approved and are described later in this report. Of those applications not approved, nine had not secured matching financing, eight were businesses that would compete unfairly with existing businesses, two were not credit worthy, three had poor quality job and salary levels, and one was withdrawn by the applicant. This does not include preapplications, telephone calls and applications pending or still expected.

In addition to the above, the Division of Finance had pending, as of June 30, an additional 13 applications for over $4,000,000 (some of which have been approved since the date of this report).

PROCESS OF APPLICATION

The Board of Economic Development encourages South Dakota businesses who have plans to create new primary jobs to contact their banker, local economic development officials or the Governor's Office of Economic Development.

The Board has designed a preapplication packet which allows the applicant to provide minimal information to the staff of GOED and the Executive Committee of the Board.

After receiving a preapplication, GOED responds to the applicant with, if necessary, advice on how to make the application stronger. The preapplication is designed to be a time saver for borrowers. Applicants may also meet with the staff in person or over the telephone regularly during the application process to answer questions as they arise. This allows GOED to meet the borrower's needs using REDI, private bank financing, block grants, bond issuance, local revolving loan funds and equity.

To submit a complete application, an applicant must have a commitment for matching financing and a business plan that includes a strategy for producing, selling, and managing the business. Both of these items are required by law.

The application must be received by The Governor's Office of Economic Development at least seven (7) days before the next monthly meeting to allow the staff and Board members time to analyze the application.

RESTRICTIVE COVENANTS

If a borrower does not substantially create the jobs projected, the Board of Economic Development may either call the loan or increase the interest rate to market rate or above. This covenant prevents companies from intentionally misleading the Board on job creation projections or changing the nature of the project. If the infraction is serious, the Board can also recapture the interest subsidy.

SECTION B: ECONOMIC DEVELOPMENT ACCOMPLISHMENTS

Comparison FY 1987 & 1988 Loan Activity in GOED

1987 FY ACTIVITY (Before REDI)

Year	Company	Community	Finance Authority	SBA 504	REDI	Project
1987	PPD(USA), Inc	Madison	355,000	124,000		692,000
1987	Luverne Fire Apparatus	Brandon	580,000			600,000
1987	Rapid Packaging	Rapid City		262,000		623,700
1987	Dakota Cold Storage	Huron	1,265,000			1,500,000
TOTAL 1987 FY ACTIVITY			**2,200,000**	**386,000**		**3,415,700**

1988 FY ACTIVITY (After REDI)

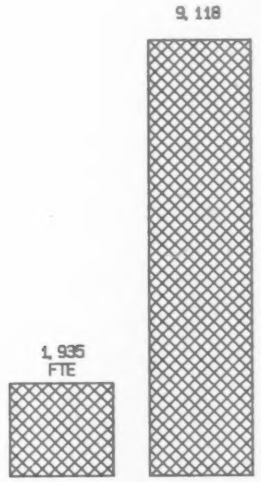
Year	Company	Community	Finance Authority	SBA 504	REDI	Project
1988	Wrapit Corporation	Howard	2,235,000		100,000	2,095,150
1988	Technical Ordinance	Clear Lake	2,210,000			2,345,000
1988	Paramount Tech. Prod.	Spearfish			130,000	397,700
1988	Greenway, Inc.	Sioux Falls		296,000		715,000
1988	Hastings Manufacturing	Yankton			500,000	1,576,000
1988	Trail King	Mitchell	1,495,000		125,000	1,802,500
1988	Palm Industries	Watertown			465,000	1,798,000
1988	Prince Manufacturing	Jefferson			400,000	2,935,000
1988	Veblen Cheese	Veblen			292,500	650,000
1988	AaLadin Industries, Inc.	Elk Point			43,000	175,183
1988	Eagle Mats, Inc.	Hot Springs			275,000	1,056,800
1988	Del's Cabinets	Brandon			45,000	100,000
1988	PPD(USA), Inc.	Madison			100,000	583,600
1988	Tea Industries	Tea			150,000	333,000
1988	Electronic Systems, Inc.	Madison			245,000	545,000
1988	Wheeler Tank Manuf.	Sioux Falls			200,000	550,000
1988	Tiger Corporation	Sioux Falls			381,600	954,000

Year	Company	Community	Finance Authority	SBA 504	REDI	Project
1988	Broin Enterprises	Scotland			112,000	312,000
1988	Excelltech	Yankton			81,000	182,000
1988	DMCO	Mobridge			36,000	145,000
1988	Hutchinson Technology	Sioux Falls			1,500,000	6,200,000
1988	Daybreak	Eureka			25,000	50,000
1988	DeGeest Manufacturing	Harrisburg			50,000	210,000
1988	Applied Engineering	Yankton			250,000	1,600,000
1988	Twin City Fan & Blower	Mitchell			558,800	2,210,000
1988	Ridco, Inc.	Rapid City			500,000	1,330,000
1988	Daktronics, Inc.	Brookings			112,500	250,000
1988	Rosebud Comm. Landfill	Rosebud			22,500	111,000
1988	Persona, Inc.	Watertown			281,700	736,600
1988	Wildcat Manufacturing	Freeman			100,000	332,500
1988	Dakota Granite	Milbank			350,000	2,153,522
1988	Tower Engineering	Elk Point			55,000	265,000
1988	Larson Manufacturing	Brookings			750,000	3,056,901
1988	Biogenetic Services, Inc.	Brookings			200,000	635,000
1988	DC Machining	Watertown			51,795	115,100
TOTAL 1988 FY LOAN AFTER REDI			5,940,000	296,000	8,488,395	39,655,966

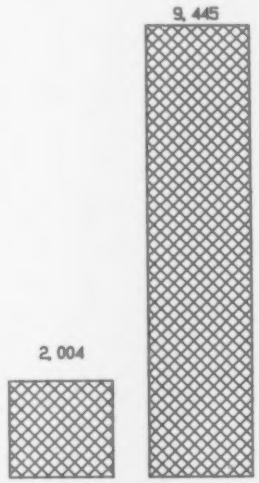
JOB CREATION

The first 33 REDI Fund borrowers will create 1,823 full time jobs and 224 part time jobs (1,935 full-time equivalent) when their businesses become fully operational. It is important to also note that there is a "ripple effect" from these REDI Fund loans. As these new and expanded industries purchase raw materials and supplies from South Dakota companies, they too are able to expand and create new jobs. These new jobs, in addition to the direct jobs created, spur on consumer spending benefiting main street businesses and the economy of the entire state. Due to this increased economic activity as a result of these REDI Fund loans, the South Dakota Department of Labor estimates there will also be over 2,000 indirect jobs created in South Dakota by 1990.

If this level of activity is maintained until the $40 million is loaned, over 9,100 direct jobs and over 9,400 indirect jobs will be created. Just jobs created from REDI Fund borrowers, this is more jobs created by the entire economy in South Dakota from 1984 through 1987 combined.

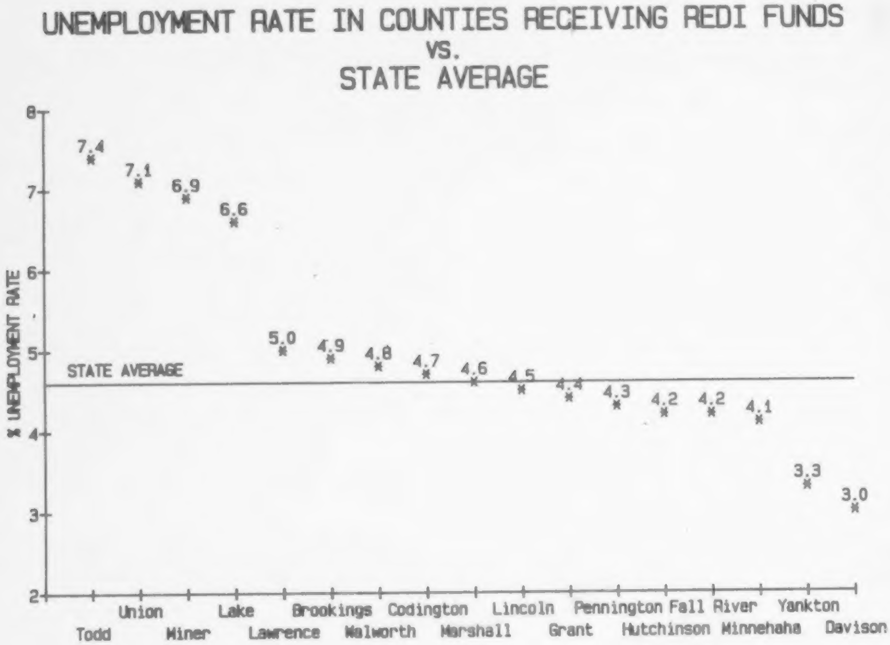


NUMBER OF DIRECT JOBS TO BE CREATED THUS FAR IN RELATION TO THE NUMBER OF DIRECT JOBS PROJECTED WHEN THE $40 MILLION WILL BE LOANED



NUMBER OF INDIRECT JOBS TO BE CREATED THUS FAR IN RELATION TO THE NUMBER OF INDIRECT JOBS PROJECTED WHEN THE $40 MILLION WILL BE LOANED

Fourteen of the REDI loans have been made to counties with unemployment rates greater than the state average. Those loans will create over 700 new employment opportunities by 1992. The Board of Economic Development has made counties that are growing slower than the state average a priority. Every effort is made to assist the job creation in these counties.


UNEMPLOYMENT RATE IN COUNTIES RECEIVING REDI FUNDS
VS.
STATE AVERAGE

The REDI Fund has had a direct and very visible impact on the local economy. Although the REDI Fund has been in operation less than a year, borrowers in the following counties have substantially completed their projects and have met or exceeded their employment goals. The employment growth in these specific counties has in all cases but one, far surpassed the state average. Employment growth in South Dakota, as a whole, increased 1.8% this year while counties like Lake, Miner and Fall River have grown by 13.5%, 12.3% and 7.2% respectively.

As of July 1, 1988, 785 South Dakotans were employed in new jobs (473 full time, 312 part time) created by those companies receiving REDI loans. In those counties where REDI Fund borrowers have substantially completed their project and hired employees, the unemployment rate has dropped as much as 5.8%.

EMPLOYMENT GROWTH

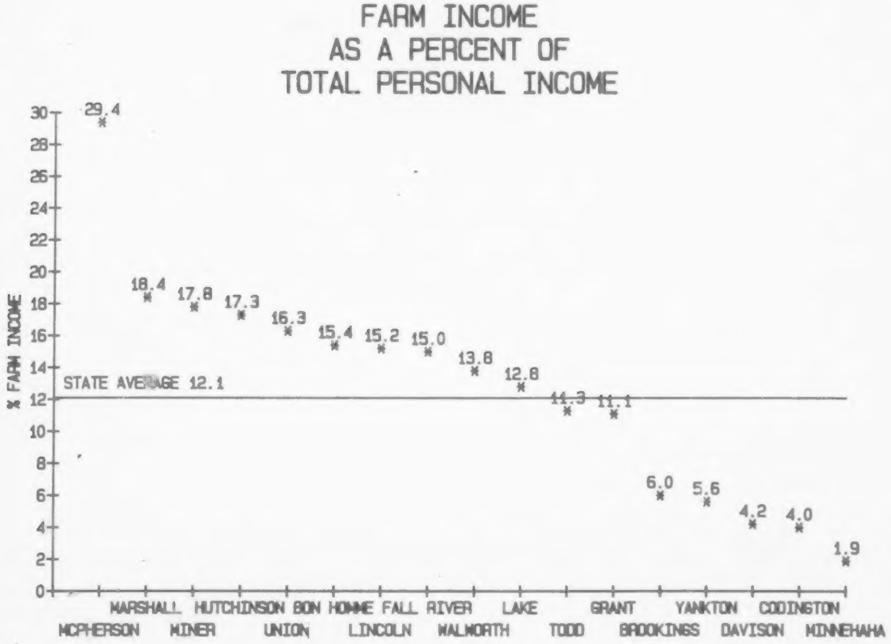
COUNTY	YEAR	EMPLOYMENT	% CHANGE
STATE AVERAGE	**1988**		**+1.8**
Davison	1987	9081	
	1988	9397	+3.5
Fall River	1987	3995	
	1988	4283	+7.2
Lake	1987	4990	
	1988	5662	+13.5
Lawrence	1987	10343	
	1988	10802	+4.4
Lincoln	1987	7132	
	1988	7322	+2.7
McPherson	1987	1729	
	1988	1787	+3.4
Miner	1987	1305	
	1988	1466	+12.3
Minnehaha	1987	71576	
	1988	72444	+1.2
Union	1987	5433	
	1988	5822	+7.2

ECONOMIC DIVERSIFICATION

A primary mission of the REDI program is to diversify South Dakota's economy. Through diversification, our state will be less dependent on any one industry and will suffer less impact when that industry experiences an economic downturn.

South Dakota has long been dependent on agriculture for its economic survival. However, due to a changing agricultural economy, we can no longer rely on the farm as our sole source of employment. We must diversify our employment opportunities. We do not want the only opportunities for our children raised on the land to be outside the state.

While all non-agricultural jobs diversify our economy, off-farm jobs created in counties more heavily dependent on agriculture will have a very large diversifying effect on the local economy. Twelve of the REDI loans, totaling $1,868,500, were made to counties where personal income has greater dependence on farm income than the state average. The jobs created in these counties offered non-farm employment opportunities. Also, several companies have created seasonal jobs during the winter which will provide additional income to farm families.



INCREASED INCOME

One of the goals of the REDI program is to provide well paying jobs for the citizens of South Dakota. There are differing expected wage rates for different skill levels within the same job categories. For example, there are both certified welders and trainee welders employed by Palm Industries. The occupational data base, provided by the South Dakota Department of Labor, includes one wage scale for these jobs. However, in reality they differ. The result is that the REDI portfolio wage average is lowered in relation to the state average.

Many of the companies provide formal training programs for new employees. After training, the employees move into higher wage levels of the same job description. Companies which have no current operations in South Dakota will cycle all of their initial employees through this process. Orientation/training drives down the average wage rates in the initial stages of the project; rates almost always rise after the start-up period. As the new workforce establishes a track-record and gains experience, wages, which were lower at the onset, will rise.

As mentioned before, a number of REDI loans have been made in areas of higher-than-average unemployment and areas which lack non-farm industry. These areas have an excess labor supply and thus have lower-than-average starting wages. REDI expansions will help to increase local wages, and the expansion will be a stepping stone in bringing local wages in line with state averages.

The South Dakota Department of Labor has analyzed jobs, by specific job category, to be created by REDI Fund borrowers with the state average wages in that category. Despite the following factors that lower wages, average wages of REDI Fund jobs are above statewide averages. This applies to management, professional and technical, and production workers.

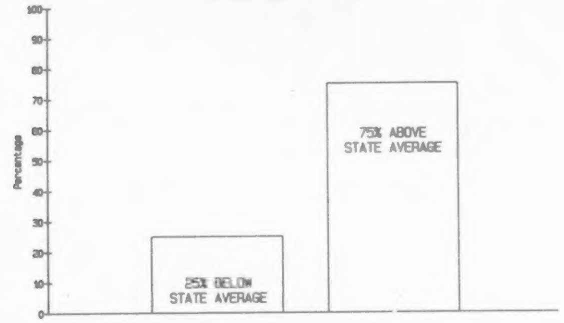
	Average Hourly Wages		
	REDI Firms	**State Avg.**	**New Jobs**
Production Workers	$5.94	$5.50	
Production & Clerical	$5.95	$5.40	
Total Employees	$6.70	$5.75	

The wage comparisons do not factor in the effect these new REDI jobs will have on existing jobs. A simple law of economics is that increased demand causes increased price. More demand for workers will increase the wages for all workers in the area.

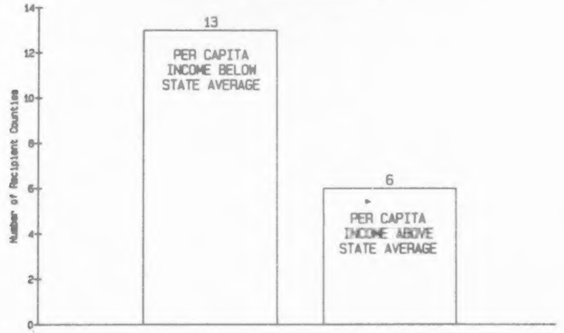
Economic studies have shown that the primary determinant of the amount of consumption is the level of income received. As the level of income rises, the amount saved also increases. This has two implications for South Dakota. First, as income rises, consumption in local and surrounding communities will rise, stimulating local businesses, which in turn will need to hire additional people. This will also generate additional income. This "multiplier" effect is calculated by the Department of Labor. Indirect employment generated by 1990 from the REDI Fund will be over 2,000 additional jobs.

Secondly, more income in a community will result in increased savings, a portion of which will stay in South Dakota for investment, providing additional local sources of capital for further expansion.

As of July 1, 1988, REDI Fund projects will create jobs in 99 categories, according to the Department of Labor. The average wages paid in 75 % of the REDI project jobs exceed the average state wage for that same job category. In the remaining 25 % of the job categories, the REDI wage is nearly comparable to the state average wage. In those categories where the REDI wage is higher than the state wage, the wage is, on average, $2.09 per hour higher. In the 25% where the state average wage is higher than the REDI wage, the state wage is, on average, only $0.69 per hour higher.

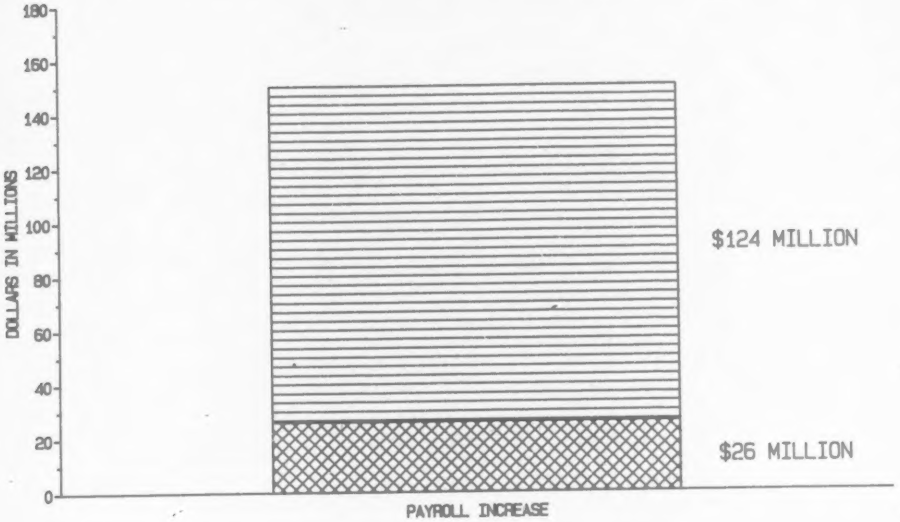

WAGES BY JOB CATEGORIES
AS COMPARED TO
AVERAGE STATE WAGE

Eighteen of the REDI loans have been made to those counties whose per capita income is less than the state average. By offering greater employment opportunities with better paying jobs, the REDI Fund will play an important role in improving the standard of living for many of our citizens.


DISTRIBUTION OF REDI LOANS
COUNTY PER CAPITA INCOMES
AS COMPARED TO STATE AVERAGE

The payroll increase on starting wages for those jobs created with the first 33 loans is approximately $26,456,000. When the full $40 million is loaned, payroll is expected to increase by approximately $123,668,000. The spin-off earnings from indirect jobs is projected to be $208,943,703.

PAYROLL INCREASE
AND PROJECTIONS WHEN
$40 MILLION IS LENT OUT

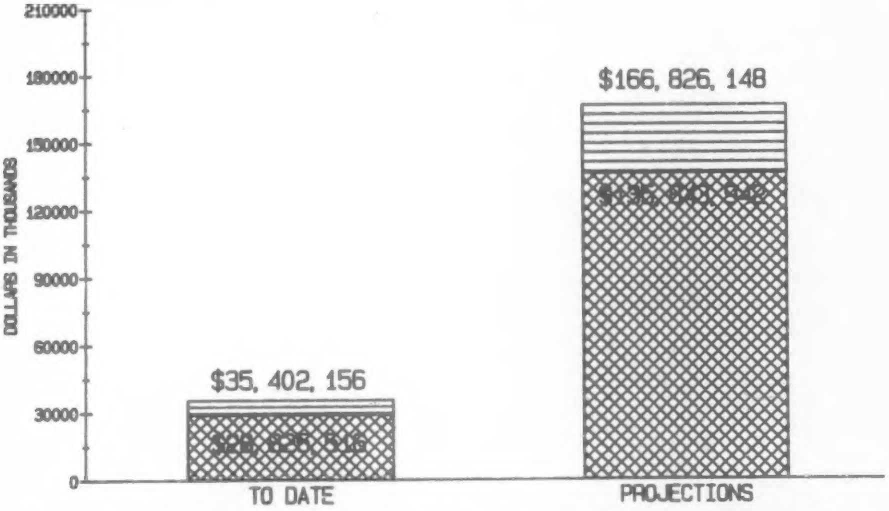


CAPITAL INVESTMENT

The REDI loans made through July 1 total $8,488,395, which will stimulate nearly $29 million in new capital investment. If current activity is maintained, over $135,834,940 in new capital investment will be generated when the full $40 million is loaned.

By providing up to 45% of the total project, the REDI program lessens the risk to the local bank as well as making capital investment available for additional economic development both on the local and state level.

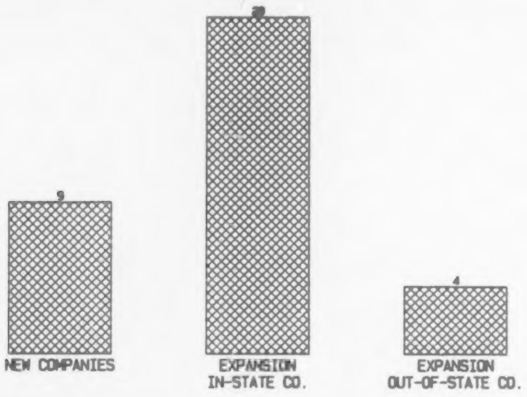
The additional tax revenue gained through the projects financed with the REDI program will also serve to benefit the state. First year total state and local tax revenue on new property and equipment totals nearly $860,000 (state: $560,878, local: $298,665), approximately 10% of the amount of our loans. The added capital investment will result in $298,665 additional annual property tax revenue for local governments.



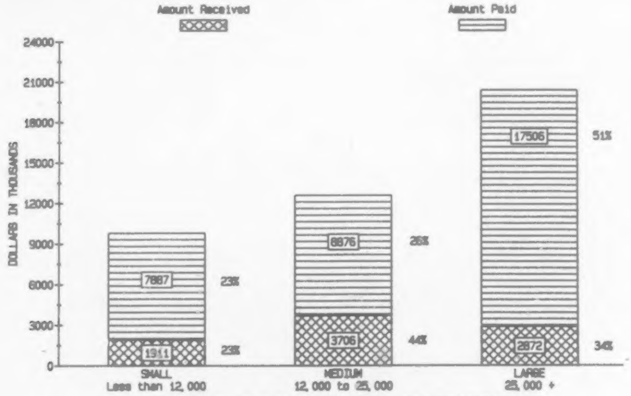
THE TOTAL AMOUNT OF CAPITAL INVESTMENT FROM REDI FUND LOANS & ITS PROJECTIONS, IN RELATION TO THE TOTAL PROJECT INVESTMENT AND ITS PROJECTIONS

DISTRIBUTION OF FUNDS

The Board of Economic Development is committed to assisting South Dakota businesses create new primary jobs. In fact, 20 of the 33 loans made have been expansions of in-state companies.



The Board is also committed to encouraging projects in smaller communities of the state. Communities with populations less than 5,000 have received 24% of the funds loaned and 16% of the funds have gone to communities of less than 2,000. Counties with populations between 12,000 and 25,000 have received 44% of the funds loaned, as opposed to the 26% of the tax revenue they generated for the REDI Fund. The smallest counties have received essentially the same percentage of funds as they paid into the REDI program.



DISTRIBUTION OF REDI FUND MONEY, IN RELATION TO THE PERCENTAGE OF WHAT WAS PAID INTO THE FUND BY SMALL, MEDIUM, AND LARGE COUNTIES

AGRICULTURAL PROCESSING

Agriculture is without a doubt, the mainstay of South Dakota's economy. Unfortunately, the past several years have shown the vulnerability of our economy to insufficient rainfall, dropping commodity prices and rising interest rates. In order to strengthen our agricultural base, more businesses that use our products and add value to commodities within the state must be developed.

The REDI Fund has taken a two-prong approach towards strengthening South Dakota's agricultural economy. The first approach is to develop commodity processors that purchase product directly from the farmer, thereby reducing shipping costs and directly increasing farm income. Veblen Cheese of Veblen purchases over $5 million of raw milk annually from area farmers. The Scotland ethanol plant, recently reopened with REDI funds, will buy over 400,000 bushels of corn annually from area farmers while selling high-quality dry distillers grain (DDG) which will give local cattle feeders better, lower cost weight gain for their stock.

The second approach taken by the REDI Fund is to finance companies developing new agricultural services. Biogenetic Services Inc. is a commercial genetic testing laboratory which will serve seed companies on a national basis. The tests determine the purity level of a random sample of seeds which would allow a company to guarantee the purity of a bag of hybrid seeds. Other tests would genetically identify traits at germination such as resistance to disease and insects rather than taking the time to grow a test plot. This means that seed companies can develop better hybrids more quickly, and that means a better crop for farmers.

At this time, the Governor's Office of Economic Development is working with three additional agricultural processing companies that would add value to South Dakota agricultural products.

CREATIVE FINANCIAL PACKAGING

GOED can structure a financing package to meet the unique needs of a business. For example, the major expansion plan for the WrapIt Corporation was a great economic opportunity for Howard, South Dakota and the surrounding area. However, the challenge was great. GOED had to have a complete financing package prepared within two weeks and have the financing in place within sixty days. If we failed, the company would have gone to Texas to fulfill the wrapping contracts with McDonald's and SportFlics (baseball cards).

The $2.8 million project was structured to lower debt service for this fast growing company and to pave the way for future development in Howard. The REDI Fund, which provided $100,000, and the Economic Development Finance Authority, which issued $2.2 million in tax-exempt bonds, provided the financing for most of the real estate and equipment. The Economic Development Administration, a federal program, provided $210,000 to assist the city with sewer, water, and utilities extentions to the industrial park. The South Dakota Department of Transportation provided $126,160 for an access road for the industrial park.

TECHNICAL INNOVATION

As our world becomes more global, the United States will produce more products that rely on the educated and creative abilities of our people. Less developed countries will produce those products that need less educated workers. South Dakota must move to production which utilizes the best talents of our citizens.

Companies like Excelltech, a computer software company in Yankton; Hutchinson Technology Incorporated and Electronic Systems, Inc., computer components manufacturers in Sioux Falls; Daktronics which manufactures scoreboards in Brookings; and Biogenetic Services Inc., a genetic seed testing laboratory also in Brookings are all examples of high technology at work in South Dakota. If these companies are successful and ride the wave of technological development in the world, they will be long-term sources of employment opportunities for the best and brightest graduates of our state's colleges and universities.

These firms demonstrate to other technology companies that South Dakota is good for high tech. A primary mission of our companion program, the Future Fund, is to encourage the research and development of high technologies. In addition to REDI Funds, the Future Fund was an integral part of encouraging the development of two of these technology based companies: Excelltech and Biogenetic Services, Inc.

SECTION C: LOAN PORTFOLIO

REDI Loan Summary Sheet

COMPANY	P-T JOBS	F-T JOBS	REDI LOAN	TOTAL PROJECT	COMMUNITY	COUNTY
Paramount Tech.	0	26	130,000	397,700	Spearfish	Lawrence
Wrap It	65	58	100,000	2,050,750	Howard	Miner
Hastings Mfg.	10	50	500,000	1,576,000	Yankton	Yankton
Palm/Angus	0	110	465,000	1,798,000	Watertown	Codington
PPD	5	45	100,000	583,600	Madison	Lake
Art Advantage	30	85	275,000	1,056,800	Hot Springs	Fall River
Veblen Cheese	0	42	292,500	650,000	Veblen	Marshall
Del's Cabinets	0	9	45,000	100,000	Brandon	Minnehaha
Prince Manf.	0	50	400,000	2,935,000	N.Sioux City	Union
Trail King	0	165	125,000	1,802,500	Mitchell	Davison
Aaladin Ind.	16	10	43,000	175,183	Elk Point	Union
ESI, Inc.	0	39	245,000	545,000	Sioux Falls	Minnehaha
Tea Industries	6	46	150,000	333,000	Tea	Lincoln
Tiger Corp	50	74	381,600	954,000	Sioux Falls	Minnehaha
Wheeler Tank	0	34	200,000	550,000	Sioux Falls	Minnehaha
Excel Tech	0	16	81,000	182,000	Yankton	Yankton
DMCO	0	7	36,000	145,000	Mobridge	Walworth
Twin City Fan	0	85	558,800	2,210,000	Mitchell	Davison
Hutchinson Tech.	0	350	1,500,000	6,200,000	Sioux Falls	Minnehaha
Daybreak	5	15	25,000	50,000	Eureka	McPherson
DeGeest	0	15	50,000	210,000	Harrisburg	Lincoln
Applied Eng.	0	39	250,000	1,600,000	Yankton	Yankton
Broin Enterprises	0	14	112,000	312,000	Scotland	Bon Homme
Daktronics	5	31	112,500	250,000	Brookings	Brookings
Persona	0	82	281,700	736,600	Watertown	Codington
Rosebud Lndfl.	0	4	22,500	111,000	Rosebud	Todd
Wildcat Mfg.	0	23	100,000	332,500	Freeman	Hutchinson
RIDCO	0	90	500,000	1,330,000	Rapid City	Pennington
Dak. Granite	0	40	350,000	2,153,522	Milbank	Grant
Tower Eng.	0	16	55,000	265,000	Elk Point	Union
Biogenetic Serv.	10	9	200,000	635,000	Brookings	Brookings
DC Machining	0	22	51,795	115,100	Watertown	Codington
Larson Manf.	22	122	750,000	3,056,901	Brookings	Brookings
TOTALS	224	1823	$8,488,395	$35,402,156	DATE: 7/1/88	

Total Number of Loans:	33
Total REDI Funds loaned:	$ 8,488,395
Capital Investment Generated:	$ 28,825,516
Total Project Investment:	$ 35,402,156
Direct Jobs (FTE) to be Created:	1,935
Indirect Jobs to be Created:	1,353
Payroll Increase w/ Starting Wages:	$ 26,455,718

HASTINGS MANUFACTURING #87-03-A **YANKTON**

Hastings Manufacturing, a worldwide marketer of piston rings and air and oil filters, expanded from its Hastings, MI plant to Yankton in 1984. In 1985 the plant doubled the size of its operation. The company is now moving some of its pre-assembly of oil and air filters as well as creating a new panel air filter product line in Yankton.

Initially this expansion will create 15 to 30 jobs; the total job creation will eventually be 50 jobs, in addition to the 75 currently employed in the other Yankton plant. The company purchased a 31,000 sq. ft. building, planning to immediately renovate and purchase equipment needed to begin manufacturing piston rings and oil filters. Hastings received $500,000 of the $1.5 million project from the REDI Fund.

Hastings offers a complete line of automotive replacement filters, piston rings, specialty tools and fuel pumps marketed under the "Hastings" brand name and a line of automotive additives marketed under the "Casite" brand name.

AALADIN INDUSTRIES #87-10-A **ELK POINT**

AaLadin Industries, Inc., manufacturers of steam and hot, high-pressure cleaners and related products, has been operating in Elk Point since January of 1981. AaLadin Industries has a wholesale network covering 43 states with the expectation of reaching all 50 states within the next two years. AaLadin is among the fastest growing in the industry and currently holds about 3.5 percent of the market.

The expansion loan covers an 11,000 sq. ft. warehouse expansion and 1,280 sq. ft. of office space and related equipment. This expansion will create 26 full-time jobs and 16 part-time jobs. As of July 1, AaLadin employed 18 new full time employees and 17 part time employees. The total expansion cost is $175,183; $43,000 being provided by REDI Funds.

PALM INDUSTRIES #87-04-A **WATERTOWN**

Palm Industries, a steel fabrication company located in Litchfield, MN, is creating a division in Watertown, called Angus Industries. Palm manufactures products such as cabs and Roll-Over Protection Systems for heavy machinery. The firm markets most of its cabs and ROPS to new equipment manufacturers such as Clark-VME, Komatsu and Koehring for installation on new machinery.

Angus is leasing a 40,000 sq. ft. building from the Watertown Development Corporation.

Angus has hired 73 full time employees and when in full production in 1989, the facility will have 110 full-time employees. These newly-created jobs will require skills in steel fabricating and bending, welding, assembling, packaging and shipping.

The total cost of this project is approximately $2,248,000; $465,000 is being provided by the REDI Fund for steel fabrication equipment.

PARAMOUNT TECHNICAL PRODUCTS #87-01-A SPEARFISH

Paramount Technical Products, formerly of Bloomington, MN, relocated its entire operation to Spearfish. Paramount manufactures a dual-membrane poly-bentonite waterproofing material which has the trade name of Paraseal. Paraseal is rated as one of the best waterproofings available in the construction industry.

The company built a 17,000 sq. ft. production facility in Spearfish and is employing 13 people and is in the process of adding another 8,000 sq. ft. to their facility. Future plans project 26 employees to join the company by the end of two years.

Paramount's application for a REDI Fund loan was the first one approved by the Board of Economic Development; receiving $130,000 from the REDI Fund. The total project cost is $390,000.

VEBLEN CHEESE #87-05-A VEBLEN

Veblen Cheese Factory, located in Veblen produces bulk cheese under the Spring Valley Farms label. The company sells to wholesalers and retailers on a nationwide basis. This company buys from farmers over $5 million worth of milk produced in South Dakota.

The Veblen Cheese Factory is a family owned and operated company. TheTobkin brothers have been operating the plant since taking it over from their father in 1977. The company is expanding its operation to include cutting, shredding and wrapping operations in addition to processing bulk cheese. The total expansion project cost is $650,000; $292,500 is provided by the REDI Fund. With this new expansion, the company expects to create 42 new jobs in addition to the 27 currently employed.

In 1987, the Tobkin brothers were named the South Dakota Small Businessmen of the Year by the Small Business Administration.

WRAPIT CORPORATION #87-02-A HOWARD

WrapIt Corporation is a package wrapping firm located in Howard. WrapIt is an affiliate of Optigraphics Corporation of Grand Prairie, TX. This firm wraps three-dimensional baseball cards with Wrigley's chewing gum for Optigraphics. The gum and cards are wrapped and packaged in a display box for stores.

The total project cost is just over $2 million; with funding of $100,000 from the REDI Fund. REDI funds helped provide financing to construct an additional 40,000 sq. ft. building and additional equipment. WrapIt has far exceeded its employment expectations. Their original projections were to hire 58 full-time employees and 65 seasonal employees, but the expansion has created 184 full-time and 248 seasonal jobs. The seasonal jobs will likely employ farm families in need of a second income. In addition, the expansion will also allow WrapIt to fill orders from other Optigraphic customers such as McDonalds, Hallmark and Kelloggs.

PPD INDUSTRIES #87-11-A **MADISON**

PPD Industries is an expansion of a Canadian company to Madison. PPD manufactures plastic parts for U.S. markets of Industries PPD, the parent company. These include drive sprockets, wheels, rotors, impellers, bushings and other parts with wear-resistant applications.

The total expansion project cost is $583,600 of which $100,000 is provided by the REDI Fund. Initially 35 new jobs are being created with projections to 45 by 1990. Currently PPD occupies a 20,000 sq. ft. building in Madison.

DEL'S CABINETS #87-07-A **BRANDON**

Del's Cabinets is a custom-cabinet manufacturer located between Brandon and Sioux Falls. It produces custom cabinetry and is currently expanding into out-of-state markets. Del's Cabinets built a 7,000 sq. ft. addition to its plant and is purchasing additional equipment. This addition will create nine new jobs when in full production in addition to the 13 people currently employed. As of July 1, two full-time and two part-time employees were hired. This is an operation where employees become qualified, skilled, cabinetmakers through the company's training program. The $100,000 project was funded in part with a $45,000 loan from the REDI Fund.

PRINCE MANUFACTURING #87-06-A **N. SIOUX CITY**

Prince Manufacturing is a Sioux City company with locations in Iowa and Nebraska. The firm manufactures a variety of hydraulic components such as cylinders, valves, motors, filters and pumps. The majority of Prince's sales are to manufacturers of farm machinery and construction equipment. Products are marketed under the Prince name and Adan hydraulic motors.

Prince Omahaline Division currently has 37 employees and projects to have 50 employees when in full production. The majority of the jobs Prince is creating will be skilled machinist positions with an average wage of $9.80 per hour.

Prince purchased a 49,000 sq. ft. building that will be used as a production facility. The REDI Fund is providing $400,000 of the $2 million project.

TRAIL KING INDUSTRIES, INC. #87-09-A **MITCHELL**

Trail King of Mitchell manufactures step deck and flat bed trailers for construction, industrial and transportation uses. Its major products are the Trail King and Trail Star brand name trailers. Since1978, Trail King has developed a dealer organization with over 250 stores in all 50 states. Most of these dealers are construction and industrial dealers with major lines such as Caterpillar, John Deere Industrial or Case Industrial Equipment. Over the past several years a transportation line of trailers has been developed for sale to national trucking accounts and truck dealers. These trailers will be constructed in a 67,500 sq. ft. production plant in Mitchell.

This has created over 330 new jobs in the first year. This exceeds the company's new employment projections for two to three years. The total cost of this project is over $2 million. The REDI Fund is loaning $125,000 for the construction of the building and new equipment.

ART ADVANTAGE, INC. #87-08-A **HOT SPRINGS**
(formerly known as Eagle Mats, Inc.)

Art Advantage Inc., a manufacturer of bevel-cut mats used for picture framing recently finished constructing a 15,000 sq. ft. addition to the facility and the purchase of additional machinery and equipment.

This expansion will create 85 new full-time and 30 part-time jobs when in full production. Eagle Mats is enlarging its current matting business which includes custom shrink-wrapping. The total project cost is over $1 million. The REDI Fund is participating by loaning the firm $275,000.

TEA INDUSTRIES, INC. #88-12-A **TEA**

Tea Industries is a manufacturer of waterbeds with sales throughout the United States and Canada. They are expanding their production facility in the Tea Industrial Park with a new, 12,000 square-foot addition. The $333,000 project is financed in part by a REDI loan of $150,000.

The purpose of their expansion is to begin production of a new line of soft-sided waterbeds to complement the component line they presently market. The project has created 42 full-time jobs and 4 part-time jobs and projects 58 within 5 years.

ELECTRONIC SYSTEMS INCORPORATED #88-01-A **SIOUX FALLS**

Electronic Systems Inc. is a Sioux Falls manufacturer of component electrical parts and circuitry including printed circuit boards used by computers, industrial control equipment, agricultural equipment and office equipment.

The company is upgrading its manufacturing equipment for entering the growing market for assemblies using surface mount technology. The project will create 39 new jobs when complete and has already created 18 full-time and 2 part-time jobs. Total cost of the project is $545,000 of which $245,000 are funds from REDI.

TIGER CORPORATION #88-02-A **SIOUX FALLS**

Tiger Corporation is a manufacturer of hydraulic mowing equipment used for highway and road right-of-way maintenance by many governmental agencies. They produce a line a hydraulic boom mowers, flail and rotary gang mowers, and hydraulic ditching equipment.

Tiger is purchasing an existing production facility and building an addition to give them a production facility of approximately 38,000 square feet. Total cost of the project is $954,000 with $381,600 in REDI financing. Tiger has employed three new full time and 22 part time employees and projects adding a total of 74 full time and 24 part time jobs with their expansion.

WHEELER TANK MANUFACTURING CO. INC. #88-03-A **SIOUX FALLS**

Wheeler Tank Manufacturing is a producer of high pressure tanks custom made for a variety of uses in industry. Wheeler Tank is relocating to South Dakota from St. Paul Minnesota.

The company purchased an existing building in Sioux Falls for its operation. Total project costs were $550,000 of which $200,000 was financed by the REDI Fund. Projections show the company will have 34 employees when in full production.

EXCELLTECH, INC. #88-04-A **YANKTON**

Excelltech is a start up company that markets a computer software product called EXCELLNET which allows for the low-cost linking of personal computers. The product was developed by company founder, Jay Williams, a South Dakota native. Excelltech has employed five full-time employees.

Excelltech will market EXCELLNET nation-wide. $81,000 for marketing, working capital, and inventory financing was provided to the company by REDI for the $182,00 project.

APPLIED ENGINEERING, INC. #88-11-A **YANKTON**

Applied Engineering, a precision machining facility, manufactures machined components for aviation, aerospace, defense, communications, computer and medical industries. Applied Engineering was established in 1967 in Rochester, Minnesota and began operations in South Dakota in 1985.

The expansion includes a 4,000 square foot addition to the building and will create 39 jobs within five years. The total expansion cost is $1.6 million, $250,000 is being provided by REDI funds.

DAYBREAK #88-07-A **EUREKA**

Daybreak, Inc. is a firm that specializes in making hand-sewn, original design bedspreads and accessories. The firm markets to interior designers and specialty stores in several major metropolitan markets.

Daybreak will hire 15 new employees and purchase additional equipment as it increases marketing efforts to reach more customers and open new accounts. The $50,000 project is financed with $25,000 in REDI funds.

DeGEEST MANUFACTURING COMPANY #88-10-A **HARRISBURG**

DeGeest Manufacturing of Harrisburg supplies area manufacturers with custom fabricated steel components. DeGeest has added 4 new full-time employees and will create 15 within five years.

Their expansion includes a 7,500 square foot addition to their present facility and additional equipment to increase their production capacity. The total expansion cost is $210,000 with $50,000 being provided by the REDI Fund program.

DMCO #88-05-A MOBRIDGE

DMCO is a livestock equipment manufacturer. Products include crowder tubs and livestock handling systems, heavy duty bale feeders; livestock handling systems, heavy duty bale feeders; livestock panels, gates, and fenceline feeders.

DMCO has purchased an existing 7,500 square foot building and began operations with four new employees and expects to employ seven by 1990. The total project cost is $145,000, of which $36,000 is provided by the REDI Fund for equipment, a building and site improvements. DMCO will initially market its products in Northern and Western South Dakota and Southern North Dakota.

HUTCHINSON TECHNOLOGY #88-08-A SIOUX FALLS

Hutchinson Technology manufactures precision components for computer disk drives and other electronic applications. The firm is the world's leading supplier of suspension assemblies and holds approximately 70% of the world market. Hutchinson's major customers include IBM, Seagate Technology and Control Data.

Hutchinson has hired 250 new employees and is utilizing $1.5 million of the Revolving Economic Development and Initiative (REDI) Fund in the $6,200,000 project.

TCF AXIAL DIVISION, INC. #88-06-A MITCHELL

TCF Industries, Inc. of Minneapolis, Minnesota is opening a new plant in Mitchell. The Mitchell plant will market and manufacture a new line of vane axial, tube axial and propeller fans used for handling clean air, such as in the air conditioning of office buildings and hospitals. Industrial applications include paint booths and general ventilation of plants and paper mills.

The new plant will create 40 new jobs in the first year and expects to grow to 107 employees after five years. The expansion in Mitchell is projected to cost $2,210,000 of which $558,800 is being provided by REDI funds.

BROIN ENTERPRISES #88-09-A SCOTLAND

Broin Enterprises, Inc. is an ethanol production facility located in Scotland. Broin is the only ethanol plant located in South Dakota and will produce one million gallons of ethanol annually.

$112,000 of the Revolving Economic Development and Initiative (REDI) Fund is being used in the $312,000 project. The loan will be used for materials, labor, inventory and associated startup costs. This new business has created nine new full-time jobs and will create 14 new jobs when the project is complete.

DAKTRONICS #88-17-A **BROOKINGS**

Daktronics is a producer of electronic message centers for business and sporting use. The company is expanding to add additional production capacity for new scoreboard equipment called "Glow Cube".

Currently, the company employs 343 people. The expansion will create 28 jobs in the first year and 31 jobs when in full production. The REDI Fund program is providing $112,500 to the $250,000 project.

PERSONA, INC/JAZCO #88-16-A **WATERTOWN**

Persona, Inc. of Watertown, a manufacturer and wholesaler of signs and sign related products (sign frames, sign facing and channel letters), is expanding its operation. The company has both national and international sales and exports 99% of its production from South Dakota.

The total expansion cost is $736,000 of which $281,700 is being provided by the REDI Fund program. Currently Persona employs 77 people. The expansion will create another 82 jobs in three years.

RIDCO, INC. #88-13-A **RAPID CITY**

Ridco Inc., parent company of Mount Rushmore Black Hills Jewelry Manufacturing Company of Rapid City, will expand its Black Hills gold production to include a new line of diamond jewelry. The company manufactures and sells Black Hills gold and silver jewelry, Royal American gemstones, Rocky Mountain Lapis and Onyx and waterfall diamonds.

Ridco is building a 21,000 square foot jewelry manufacturing facility in Rapid City and projects to employ 130 people in five years. The total project costs are $1.3 million. A total of $500,000 will be from the REDI Fund.

ROSEBUD COMMUNITY LANDFILL, INC. #88-14-A **ROSEBUD**

Rosebud Landfill, a waste disposal business and landfill operation, is purchasing additional equipment to meet EPA regulations and expand its service to the Rosebud reservation.

The total expansion cost is $111,000 of which $22,500 is being provided by the REDI fund. Rosebud landfill currently employees three people. This expansion will create four new jobs by 1991 as well as additional work for young people utilized in cleaning up existing unregulated landfills.

WILDCAT MANUFACTURING COMPANY, INC. #88-15-A FREEMAN

Wildcat Manufacturing Co. of Freeman is expanding its business to purchase a new product line and build 12,600 sq. feet in additional production space.

Their new product, called the Roadpatcher, is a one-person road maintenance machine used for filling potholes. 22 additional jobs,which include sales, product design and drafting, promotional and public relations personnel, office staff and manufacturing jobs were created with the expansion. Other machines produced by the company are snow blowers and compost turners for agricultural and government use.

The total project costs are $412,250. Wildcat will receive $100,000 in REDI Funds.

DAKOTA GRANITE #88-19-A MILBANK

Dakota Granite of Milbank is expanding its operation to include a granite tile production line. Currently the company produces monument block and graded building block.

Dakota Granite was established in 1925 and presently employs 87 people. This expansion will create 60 jobs over three years. The total expansion cost is $2,153,522 of which the REDI Fund will provide $350,000.

TOWER ENGINEERING AND CONSTRUCTION #88-18-A ELK POINT

Tower Engineering designs, fabricates and erects large microwave communication towers. The company was approved for a REDI Fund loan to add steel fabrication equipment.

Tower was recently awarded a $2 million contract with the U.S. Coast Guard, and a $1 million contract with the Hazeltine Corporation, a large supplier of defense equipment.

The company currently employs four people and will employ 16 additional people with this expansion. The REDI Fund program will provide $55,000 of the $264,000 total expansion cost.

BIOGENETIC SERVICES, INC #88-20-A BROOKINGS

Biogenetic Services, Inc., is a new business that will utilize molecular genetic technology to provide information on purity levels, hybrid and inbred seeds and genotypes ("fingerprinting") of seeds.

Initially, emphasis is on providing information on purity levels and genotypes of inbred and hybrid corn to private seed companies, foundation seed companies, farmers and university scientists throughout the United States and abroad.

The target market initially will include any company, public institution or individual who is engaged in the development and production of seeds.

Biogenetic Services, Inc. is offering state-of-the-art services that are on the cutting edge of agricultural technology. With only one other company providing only some of the services, this market is largely untapped. This technology will allow seed companies to identify traits such as resistance to disease and insects through DNA rather than the lengthy and less accurate method of field growout. Ultimately, the farmer benefits from this technology through higher yields and increased profits.

The company will begin operation with nine full-time and 10 part-time employees. The rate of employment growth will depend to some degree on expansion of services into animal testing.

Initial start-up costs for the project were estimated at $585,000 in the first year. The REDI Fund is providing $200,000. Funding will be used for the purchase of equipment, beginning inventory and working capital for the first year.

DC MACHINING, INC. #88-21-A WATERTOWN

DC Machining is a technical business which performs precision machining functions for several industrial companies.

The recent industrial expansion in Watertown has created a unique market for a line of automatic screw machine services which is currently being supplied by out-of-state companies. The REDI loan allows the automatic screw machine business to remain in Watertown, creating a projected 27 direct jobs by 1992, as well as additional indirect jobs.

The total expansion cost is $115,100 and will allow DC Machining to lease an existing empty facility in Watertown and purchase several automatic screw machines. The REDI Fund will provide $51,795 and a local bank will provide $63,305.

LARSON MANUFACTURING #88-22-A BROOKINGS

Larson Manufacturing Company, Brookings, is a manufacturer and wholesaler of aluminum wood core storm doors, storm windows and other energy saving storm products.

The company began its operation in Iowa and was established in South Dakota in 1964. Larson Manufacturing Company plans an expansion that will provide for the purchase of additional land, construction and equipping of an 18,000 square foot addition on the existing plant to house additional production and distribution and a 21,050 square foot addition for administration, customer service, marketing and management.

Larson Manufacturing Company has 11 other plants in the United States. Currently, the company employs 203 full-time and 50 part-time employees in its 12 locations. The expansion is expected to created 122 full-time and 22 part-time jobs by 1992 at the Brookings plant.

Total project cost for the expansion is $3,056,901. Larson Manufacturing Company is receiving $750,000 in REDI Fund financing.

Current Loan Status

FIRST REMITTANCE AND NEXT PAYMENT DATES FOR REDI AS OF 06/30/88

	First Payment Received	Next Payment
Aaladin Industries		07/13/88
Art Advantage	05/31/88	08/14/88
Applied Engineering		not closed*
Biogenetics Services, Inc.		not closed*
Broin Enterprises		11/11/88
Dakota Granite		not closed*
Daktronics, Inc.		09/25/88
Daybreak		12/25/88
DC Machining		not closed*
Degeest Manufacturing		08/06/88
Del's Cabinets	06/22/88	09/05/88
DMCO		10/08/88
Electronic Systems, Inc.	06/06/88	09/21/88
Excelltech, Inc.		08/12/88
Hastings Manufacturing	06/09/88	09/27/88
Hutchinson Technology		08-20-88
Larson Manufacturing		not closed*
Lomar Development Corp.		not closed*
Palm Industries		07/27/88
Paramount Technical Products, Inc.	06/08/88	08/11/88
Persona/Jazco Inc.		not closed*
Prince Manufacturing	06/17/88	09/14/88
PPD (USA), Inc.		07/13/88
Ridco, Inc.		not closed*
Rosebud Comm. Landfill		not closed*
Tea Industries		08/23/88
Tiger Corporation		07/06/88
Tower Engineering		09/18/88
Trail King		08/10/88
Veblen Cheese		10/11/88
Wheeler Tank Manufacturing		07/06/88
Wildcat Inc.		not closed*
WrapIt Corporation		09/01/88

As of June 30, 1988 all REDI Fund loans are current and borrowers are fulfilling the requirements of the loans. Terms and conditions of loans are outlined in the Board minutes which have been filed with Legislative Audit.

* "Not closed" loans have been approved by the Board of Economic Development but the loan has not yet been closed. Most borrowers utilize interim bank financing, as is the standard in the finance industry, until the project is completed. At that time, the REDI Fund loan is closed and funds are disbursed.

SECTION D: STATEMENTS OF AUDITING

The Board of Economic Development requested the Banking Commission to examine the REDI portfolio for conformance to banking procedures and standards. The Board also requested Legislative Audit to examine the portfolio for adherance to the law and Administrative Rules. The following are those Auditing Statements.

Department of Commerce and Regulation
DIVISION OF BANKING
State Capitol — 500 East Capitol
Pierre, South Dakota 57501-5070
Phone 605/773-3421

JUL 1988
RECEIVED
GOED/
Tourism

MEMO

TO: Troy Jones, Director of Finance
Office of Economic Development

FROM: Richard A. Duncan, Director of Banking

REGARDING: Review of Loans

DATE: July 25, 1988

A review was conducted by Richard L. Barrie, Examiner from this Division, of a representative portion of the loans that have been closed by your office as of July 18, 1988.

The credit files were reviewed for proper documentation in accordance with regulatory guidelines. No major deficiencies were noted in the files, with a few items reviewed with loan officer Mark Schuler. This Department has their own loan policies to follow and guidelines to adhere to, and it is apparent that they are followed very closely. Credit file documentation is considered very good.

Current financial information was reviewed on the borrowers. No loans were analyzed for soundness due to their recent originations.

It was recommended by loan officer Mark Schuler that this review be continued on an annual basis at approximately the same time of year. At that time, individual loans could be analyzed as this Division does on a regular examination basis.

At the present time, it appears the staff is operating quite efficiently.

If you need anything further from us, please advise.

STATE OF SOUTH DAKOTA
DEPARTMENT OF LEGISLATIVE AUDIT

Maurice C. Christiansen, CPA
AUDITOR GENERAL

435 SOUTH CHAPELLE
PIERRE, S.D. 57501-3292
(605) 773-3595

002333

George S. Mickelson
Governor of South Dakota

and

South Dakota Board of Economic Development

Pursuant to a June 21, 1988 request from the Governor's Office of Economic Development, we have performed a limited review of the Revolving Economic Development and Initiative (REDI) Fund loan program. Our limited review was made solely to determine if selected loans were in compliance with applicable South Dakota Codified Laws and Administrative Rules of South Dakota. Our report is not to be used for any other purposes.

The procedures we performed are summarized below:

(a) We reviewed applicable South Dakota Codified Laws and Administrative Rules.

(b) We interviewed key personnel.

(c) We reviewed a sample of loan files and other documentation as we deemed necessary.

Because the above procedures do not constitute an examination made in accordance with generally accepted auditing standards, we do not express an opinion on the Revolving Economic Development and Initiative Fund. In connection with the procedures referred to above, the Governor's Office of Economic Development complied with South Dakota Codified Laws and Administrative Rules of South Dakota applicable to the Revolving Economic Development and Initiative Fund loan program in all material respects. This report relates only to the matters discussed above and does not extend to, and we do not express an opinion on, any financial statements of the Governor's Office of Economic Development.

Maurice C. Christiansen

Maurice C. Christiansen, CPA
Auditor General

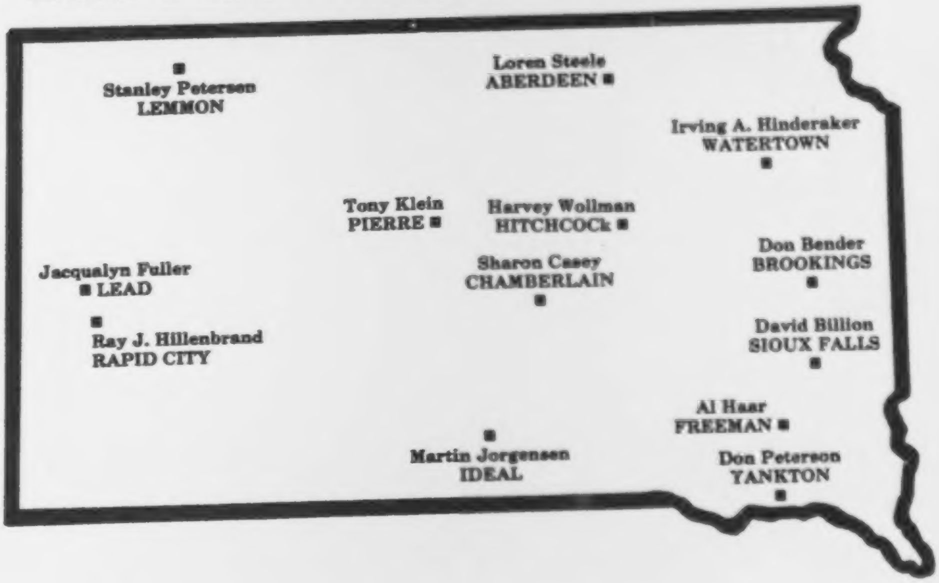
August 11, 1988

SECTION E: THE OPERATION OF THE REDI FUND

Board:

Name	City	Occupation
David Billion, Chairman	Sioux Falls	Businessman
Loren Steele, Vice Chairman	Aberdeen	Businessman
Irving Hinderaker, Secretary	Watertown	Attorney
Don Bender	Brookings	Manufacturer
Don Peterson	Yankton	Ag/Businessman
Sharon Casey	Chamberlain	Businesswoman
Jacqualyn Fuller	Lead	Businesswoman
Martin Jorgenson	Ideal	Farmer/Rancher
Harvey Wollman	Hitchcock	Farmer
Tony Klein	Pierre	Businessman
Stanley Petersen	Lemmon	Banker
Ray Hillenbrand	Rapid City	Businessman
Al Haar	Freeman	Businessman

Board of Economic Development


Stanley Petersen
LEMMON
Loren Steele
ABERDEEN
Irving A. Hinderaker
WATERTOWN
Tony Klein
PIERRE
Harvey Wollman
HITCHCOCk
Don Bender
BROOKINGS
Sharon Casey
CHAMBERLAIN
Jacqualyn Fuller
LEAD
Ray J. Hillenbrand
RAPID CITY
David Billion
SIOUX FALLS
Al Haar
FREEMAN
Martin Jorgensen
IDEAL
Don Peterson
YANKTON

Staff

Commissioner Ron R. Reed, directs and supervises the operation of GOED, including the Division of Finance. Reed has 22 years of business management and industrial development experience. In that capacity he has served for two and a half years as a member of the board of directors of the Business Economic Development Center in Brookings. He was also the executive vice president and director of industrial development of the Brookings Area Chamber of Commerce for eleven years.

Director of Finance Troy Jones, Jr. manages the Revolving Economic Development & Initiative Fund, the South Dakota Economic Development Finance Authority, the South Dakota Development Corporation, supervises the division staff, and coordinates the Governor's and commissioner's economic development agenda with the financing programs. Jones has been with GOED since April 1987. Before joining GOED, Jones spent six years in private-public sector liaison work and private business management. Jones has a B.B.A. in Business Administration-Finance from George Washington University.

Carol Butzman is staff secretary to the Division of Finance, the South Dakota Board of Economic Development, the South Dakota Economic Development Finance Authority, and the South Dakota Development Corporation. She provides support for operations and programs directly to Troy Jones, Jr., Board members, and staff. Ms. Butzman was formerly employed at American State Bank as loan secretary and receptionist.

Finance Authority Coordinator and Loan Officer Cindy M. Mydland is responsible for the Finance Authority's day-to-day activity as well as serving as a loan officer to individual borrowers. Mydland has been with the Governor's Office of Economic Development, previously State Development, for the past two and a half years. Before that she was a Housing Management Officer with the South Dakota Housing Development Authority. She has a B.S. in Business Administration from the University of South Dakota.

Mark Schuler is the REDI Fund Coordinator and Loan Officer and is responsible for the day-to-day activities of the REDI Fund, management of the REDI Fund loan portfolio, and serves as a loan officer for individual borrowers. He is a graduate of the University of South Dakota and University of South Dakota School of Law. Schuler is a member of the state bar of South Dakota and was formerly bank counsel for First National Bank, Pierre.

Todd VanderVorst is staff coordinator of South Dakota Development Corporation and loan officer. He manages the day-to-day activities of the SDDC program and serves as loan officer for individual applicants. VanderVorst joined the Governor's Office of Economic Development in September, 1987 as the REDI Fund assistant and became coordinator of the SDDC program in April of 1988. He graduated from the University of South Dakota in 1987 with a B.S. in Business Administration.

REDI Fund Assistant Kersten L. Johnson is responsible for reviewing preapplications, answering inquiries on the REDI program, and assisting in the preparation of financial analysis of the applications. She is also responsible for maintaining the statistical information on the REDI program. Johnson is a 1987 graduate of the University of South Dakota and was formerly program coordinator for the South Dakota Office of Volunteerism.

Loan Documentation and Review Officer Carol Jean Gengler is responsible for early detection of potential problem loans and consults with division director and loan officers on any corrective action. She records and updates files with financial, employment, and lender information. Gengler is a 1988 graduate of Black Hills State College with a B.S. in Business Administration and was formerly self-employed in the private sector.

Community Development Block Grant Special Projects Coordinator Steve Harding works with the REDI Fund coordinating economic development projects with the CDBG program. He is a graduate of Black Hills State College and was formerly involved in private business management.

SECTION F: MISCELLANEOUS

LABOR FORCE, EMPLOYMENT, AND UNEMPLOYMENT RATE

Reference Period: 1987 annual average

Source S.D. Data: South Dakota Department of Labor, Labor Market Information Center, 2/12/88.

Source U.S. Data: Employment and Earnings, U.S. Department of Labor, Bureau of Labor Statistics, May 1988.

South Dakota unemployment rate: 4.2

United States unemployment rate: 6.2

POPULATION

Reference Period: 1980 and 1986

Source: Current Population Reports, "Local Population Estimates", U.S. Department of Commerce, Bureau of Census, Series P-26, No. 86-WNC-SC, March 1988.

PER CAPITA AND PERSONAL INCOME AND FARM INCOME AS A PERCENT OF TOTAL INCOME

Reference Period: 1984 and 1986

Sources: U.S. Department of Commerce, Bureau of Economic Analysis, April 1986. U.S. Department of Commerce, Bureau of Economic Analysis, SURVEY OF CURRENT BUSINESS, Volume 68, No. 4, April, 1988.

South Dakota per capita income (1985):	$11,035
United States per capita income (1985):	$13,908
Ranking (1985): 42nd highest among 50 states	
South Dakota per capita income (1986):	$11,811
United States per capita income (1986):	$14,636
Ranking (1986): 40th highest among 50 states	
South Dakota farm income as a percent of total income (1984):	12.1%
United States farm income as a percent of total income (1984):	1.4%
Ranking (1984): 1st among 50 states	

NONFARM WAGE AND SALARIED EMPLOYMENT

Reference period: 1980 and 1987 annual averages

Sources: South Dakota Department of Labor, Labor Market Information Center 2/88.

U.S. Department of Labor, Bureau of Labor Statistics, EMPLOYMENT AND EARNINGS, May 1983.

U.S. Department of Labor, Bureau of Labor Statistics, EMPLOYMENT AND EARNINGS, May 1988.

South Dakota's change in nonfarm wage and salaried employment 1980-1987:	7.1%
United States' change in nonfarm wage and salaried employment 1980-1987:	12.9%
Ranking: 35th among 50 states.	

EMPLOYMENT PLAN COMPARISON

Reference period: Dependent upon industry of applicant. Could include 1985, 1986 or 1987 staffing patterns from the Occupational Employment Statistics survey.
Source: Occupational Employment Statistics program, South Dakota Department of Labor, Labor Market Information Center, 7/22/88.

WAGE AND SALARY PLAN COMPARISON

Reference Period: 1987
Source: South Dakota Occupational Outlook Handbook, 3rd Edition, South Dakota Department of Labor, Labor Market Information Center, 1987.
South Dakota Occupational Wage Information, South Dakota Department of Labor, Labor Market Information Center, July 1987.

Submitted to the South Dakota Legislature Friday, Sept. 1, 1988.

For additional information or copies, contact the Governor's Office of Economic Development, Capitol Lake Plaza, Pierre, S.D. 57501, (605) 773-5032.

South Dakota
GOVERNOR'S OFFICE OF ECONOMIC DEVELOPMENT

Governor George S. Mickelson's

SOUTH DAKOTA'S FUTURE FUND REPORT, 1987

Governor's Office Of Economic Development
Capitol Lake Plaza
Pierre, South Dakota 57501
605-773-5032

1889

STATE OF SOUTH DAKOTA
EXECUTIVE OFFICE
STATE CAPITOL BUILDING
PIERRE, SOUTH DAKOTA 57501

GEORGE S. MICKELSON
GOVERNOR

(605) 773-3212

MEMORANDUM

TO: Members of the South Dakota Legislature

FROM: Governor George S. Mickelson

DATE: January 12, 1988

SUBJECT: South Dakota Future Fund

I want to take a moment to provide you with information on the activities surrounding the South Dakota Future Fund. As you probably know, we have created Centers for Innovation Technology and Enterprise (CITE) on each state-funded college and university campus. Each CITE has a director and works directly with the Governor's Office of Economic Development.

You will recall that the "Employers' Investment in South Dakota's Future Fund" was created during the last legislative session, using the formula for collection of the Unemployment Insurance Fund. Employers across South Dakota delayed a decrease in their contributions so the fund could be established.

The purpose of this program is to encourage research and development partnerships between higher education and private/public sector businesses and individuals. Even though the program has not had time to mature, the initial results are already very encouraging.

On September 1, 1987, the first round of proposals was funded. Approximately 50 proposals, worth $1.6 million, were received from the institutions. After careful scrutiny, $532,799 was expended on 14 projects. The projects range from research on highly technical mineral extraction methods and UHF communication equipment to research on the marketability of our native grasses and sedges and producing compost that will grow high quality mushrooms.

The following interim report is provided to you so that you can see some of the tangible results of your prudence in making the South Dakota Future Fund available for research and economic development.

SUMMARY

Proposals Funded in 1987	14
Funded proposals completed as of Dec. 31, 1987	1
Funded proposals still in process of completion	13
Total dollars funded (14 projects)	$532,799
Total amount of proposals received by GOED	$1,590,629

1987 CITE PROPOSALS FUNDED

SOUTH DAKOTA SCHOOL OF MINES AND TECHNOLOGY

1.	Development of Chlorine Extraction Techology	$71,800
2.	Geothermal Resources in Western South Dakota	$53,800
3.	South Dakota Forest Products, Inc.	$85,000
	TOTAL	$210,600

SOUTH DAKOTA STATE UNIVERSITY

1.	Aerospace/Defense Initiative	$42,638
2.	Critical Bandpass Filters	$17,700
3.	White Corn Development	$11,500
4.	Native Grasses, Sedges	$10,461
5.	High Yielding Mushroom Compost	$37,000
	TOTAL	$119,299

UNIVERSITY OF SOUTH DAKOTA

1.	Small Business Development Center	$108,000
2.	Computer Cognition	$10,000
3.	Dakota Granite	$31,900
	TOTAL	$149,900

DAKOTA STATE COLLEGE

1.	Utilization of DSC Small Business Institute as SBIR Information Center	$27,000
	TOTAL	$27,000

NORTHERN STATE COLLEGE

1.	Northeastern South Dakota Rural Development Resource Center (RDRC) "Clark Project"	$15,500
2.	Dakotah, Inc.	$10,500
	TOTAL	$26,000

BLACK HILLS STATE COLLEGE

1.	Geothermal Resources(Cooperation with SDSM&T)	--------
	TOTAL 14 PROJECTS =	$532,799

SUMMARY OF 1987 RESEARCH PROPOSALS

SOUTH DAKOTA SCHOOL OF MINES AND TECHNOLOGY

1. Development of Chlorine Extraction Technology

Budget ---$71,800
Completion Date ---8/31/1988

Trends and Accomplishments:

- 0 Gold scrap from Black Hills gold jewelry manufacturing can be easily refined by chlorination.
- 0 Gold, arsenic and mercury can be removed from Whitewood Creek tailings placer deposits by cholorination. Arsenic and mercury pose considerable problems currently when using conventional means of reclamation.
- 0 Purity levels of gold recovered from the scrap run in excess of 99 percent.
- 0 The result of gold scrap chlorination has been so favorable that Chlor-Pure Corporation has entered into contract negotiations with a firm that will market locally manufactured and licensed chlorination units worldwide for the refining of high grade gold scrap.

Explanation: This project has four phases: Development of (1) an inventory of Black Hills and western regional gold ores and their chlorination potential; (2) a laboratory-scale, working model of a gold scrap recovery system; (3) an experimental data base for establishing economic feasibility and for designing commercial reactors; (4) an inventory of Black Hills metallic ores, other than gold and their potential for extraction by chlorination.

2. Geothermal Resources In Western South Dakota

Budget ---$53,000
Completion Date ---8/31/1988

Trends and Accomplishments:

- 0 Six communities have been visited and two companies have been escorted to geothermal localities with the intent of convincing these companies to locate businesses in South Dakota.
- 0 A list has been prepared of all known geothermal water users in South Dakota.
- 0 Documentation as been gathered on geothermal resources in western South Dakota.

Explanation: This project is being jointly accomplish by SDSM&T and Black Hills State College. It has identified hot-water acquifers and seeks to find applications for the geothermal resources. Typical agricultural requirements and tourism benefits are being assessed and a prospectus is being prepared for each suitable site to attract new industries in South Dakota and help create jobs.

3. **South Dakota Forest Products, Inc.**

Budget ---$85,000
Completion Date ---Summer, 1988

Trends and Accomplishments:

- 0 Studies have been completed on: (1) toxicity, using "comet" gold fish; (2) thermal transmission properties of Gainsan wood; (3) fire retardancy tests; (4) chemical composition of the effluent stream.
- 0 Studies initiated and remain in process include: (1) four environmental studies; (2) recycling of the effluent stream to improve the economics of the process; (3) studies on fire-retardant Gainsan wood; (4) use of other soft woods in Gainsan process.
- 0 Gainsan treated pine is essentially non-toxic to fish and definitely less toxic than untreated pine.
- 0 Gainsan treated pine has an increased insulating value over untreated pine.
- 0 Gainsan treated pine varies little from untreated pine on fire retardancy at present, but studies are underway on a further treatment with known retardant chemicals.

Explanation: This grant was made to help speed the development and commercialization of the new Gaisan wood staining process. The process can be used to treat a softwood, like pine, so that it looks and performs like more expensive hardwoods. South Dakota Forest Products, Inc., has been issued a license to use the process. SD Forest Products has erected a pilot plant in Rapid City to develop parameters for a commercial plant. SD Forest Products expects to have a plant in place sometime in February which will produce 1.5 million board feet annually. Patent applications have been filed and are assigned to the SDSM&T Foundation Research Center, Inc.

SOUTH DAKOTA STATE UNIVERSITY

1. **Aerospace/Defense Initiative**

Budget ---$42,638
Completion Date ---4/1/1988

Trends and accomplishments:

- 0 Contacts have been identified in Dallas, San Diego, Indianapolis and 12 prime contractors and defense logistics agencies have been visited.
- 0 Joseph Kobylack, Dayton, Ohio; Robert Moen, Phoenix, Ariz.; and George Hawley, Arlington, Texas, have been established as South Dakota's economic development representatives.
- 0 Reports from above representatives have been given to South Dakota manufacturers regarding opportunities.

- 0 A data base is currently being developed so that new business opportunities can be matched with manufacturer capabilities.
- 0 Field visits have resulted in considerable information which South Dakota manufacturers must assimilate and implement to attain bids. Most small companies feel overwhelmed and awe-struck when first confronted with the information. They hesitate to implement the necessary effort.
- 0 The next phase is to help firms learn the process and assist them with military specifications.

Explanation: This project's intent is to help land aerospace business for firms in the state. Representatives in four prime aerospace company locations (Dallas, San Diego, Indianapolis, Dayton) were to be identified. These representatives were to have ties with prime or major contractors and with South Dakota. An automated data base profile of South Dakota manufacturers is to be developed to match them with other developing business opportunities in the future.

2. Critical Bandpass Filters

Bugeted ---$17,700
Completion Date ---3/1/1988

Trends and Accomplishments:

- 0 The design for a prototype channel filter for the TerraSat System has been carried out and modeled on computer. It incorporates a novel approach to the use of a microstrip resonant ring.
- 0 Sample sections of the filter needs to be tested and an entire filter is to be constructed. The prototype will be completed in early March of 1988.

Explanation: South Dakota State University and Anderson Scientific, Inc., of Rapid City joined together in this project to develop a special bandpass filter needed to create a "wireless" community cable system. SDSU is providing engineering expertise and facilities to design, fabricate and test a prototype channel filter. The bandpass filter is needed for the TerraSat System under development by Anderson Scientific, a manufacturer of satellite television receiving systems and components. The TerraSat System receives satellite TV signals and rebroadcasts them in the UHF band. These UHF signals will be receivable through an inexpensive antenna-receiver-decoder which will be attached to a standard TV set. The concept is truly revolutionary with applications world-wide. In fact, there is no application foreseen in the U.S. because of frequency band allocations precluding its use.

3. White Corn Development

Budget ---$11,500
Completion Date ---1/1/1988

Trends and Accomplishments:

- Study results demonstrate a favorable economic feasibility for commercial production of white corn in South Dakota.
- Trials of SDSU experimental white corn hybrids indicate that the crop can be adapted to South Dakota dryland conditions.
- White corn industry demands strict quality standards. Of the 75 hybrids evaluated, 25 were acceptable for yield, moisture and agronomic characteristics. Of the 25, only one was rated average for milling by the Quaker Oats Company. This hybrid also rated acceptable in Frito Lay tests.
- Additional trials planned for the coming season, in environments which should maximize yield and quality, will demonstrate how much potential can be realized by SDSU experimental hybrids.
- Sale of South Dakota proprietary hybrids to national and international markets depends on their ability to satisfy strict milling quality standards. Trends suggest that South Dakota's hybrids can meet quality standards.
- Economic feasibility prospects for white corn depends not only on the solution of technical agronomic problems(environmental), but also on the availability of contracts from front-end users to prospective South Dakota growers rather than sale on the open market.

Explanation: This project assessed the impact of the development of white corn hybrids in the state for potential sale into national and international markets as well as assessing the potential of white corn as an alternative agricultural enterprise for South Dakota agricultural producers. The proposal covered the first of a two-phase project.

4. Native Grasses, Sedges, Rushes

Budget ---$10,461
Completion Date ---January/1988

Trends and Accomplishments:

- Returns so far from a survey, which included a sample of the dried product, indicates that 60 percent of those who responded have an interest in purchasing the product at a price between $2 and $6.
- Interest in the product appears not to be restricted to a particular geographical region. However, the East Coast may be the most profitable region in which to seek buyers.
- Trend suggests the products are marketable as dried materials for use in floral arrangements.

Explanation: This proposal was to determine nationwide demand and marketability of native grasses, sedges and rushes for utilization in dried floral arrangements. The research included products grown on land not suitable for production of conventional crops. It was felt that plant species that stabilize soils and protect water quality would be even more useful and valuable if marketable products other than forage could be obtained from them.

5. High Yielding Mushroom Compost

Budget ---$37,000
Completion Date ---1/31/1988

Trends and Accomplishments:

0 Chemical analyses of raw materials and changes in compost formulation have allowed Quality Compost to reduce production costs from $10 per bag to $6 per bag, while increasing mushroom yields from 5-10 lbs per bag to 12-20 lbs per bag.

0 Increased attention to proper mixing, watering and ventilation during phase I has reduced processing time from 30 days to 10 days. These changes have improved process efficiency, reduced energy costs, and allowed the company to reduce energy bills from $8,000 to $1,000 per month. These changes should also increase the life expectancy of the plant.

0 To address the problems of grower proficiency and grower numbers, an intensive grower education program has been initiated by SDSU in cooperation with Quality Compost and the North Central Mushroom Growers Association. Grower proficiency and grower numbers are the main factors limiting continued growth of this industry in South Dakota.

Explanation: This project provides technical assistance to Elkton Mushroom, Inc.(EMI). EMI reorganized under Chapter 11 bankruptcy laws and approached SDSU for assistance in solving technical production problems. At its peak, EMI sold compost to 91 local growers who produced 30,000 pounds of mushrooms per week which were sold in five-states. Over 250 new jobs were created by this industry. Problems were traced to the firm's past technical consultants. The result had been the production of poor quality compost which growers refused to purchase. EMI was established in 1985.

UNIVERSITY OF SOUTH DAKOTA

1. Small Business Development Center

Budget ---$108,000
Completion Date ---9/30/1988

Trends and Accomplishments:

0 SBDC began operation in Sioux Falls September 1 to serve

Buffalo, Brule, Aurora, Davison, Hanson, McCook and Minnehaha couties.

- 0 38 clients were assisted by the Sioux Falls SBDC in the first four months of full-time operation versus 48 the previous two years.
- 0 Research support is being provided to each of the SBDC subcenters; such as assistance to the Belle Fourche Woolen Mills and assistance to a client interested in opening a photography studio.
- 0 Five research assistants have been hired in Vermillion, Aberdeen, Watertown and Rapid City to support SBDC area directors.

Explantion: This proposal enables the state to provide technical assistance to more current and potential businesses than possible under past levels of funding of the SBDC, State Data Center and the International Trade Center. This grant matches SBA funds.

2. Computer Cognition

Budget ---$10,000
Completion Date ---fall, 1988

Trends and Accomplishments:

- 0 John Ambrose of Computer Cognition attended a federal research conference in Salt Lake City. The conference was a broad-based information source on research contracts under SBIR, the role of state institutions of higher learning in the SBIR process and state strategies for the growth of diversified economy and for limiting the flight of the young from small, single industry dominated states. This information is being shared.
- 0 Computer Cognition has been very successful in the SBIR program. The firm is currently completing work on a $800,000 Phase II contract with the Navy in the area of artificial intelligence.

Explanation: Considerable grant and contract information can be obtained from printed sources, computer data and telephone conversations with funding agency personnel. However, major grants, especially those which are multidisciplinary, require personal consultation. Computer Cognition and USD's Office of Research are sharing in the cost of five such consultations to Washington D.C. as a result of this grant. The grant funds provide approximately one-third of the costs.

3. Dakota Granite

Budget ---$31,900
Completion Date ---April, 1988

Trends and Accomplishments:

- 0 Research is showing that there seems to be a better market for the tile products in the immediate geographical area around the mill where the tiles are made.

- 0 Dakota Granite is impressed with early results of the research. When the research is complete, Dakota Granite will make an in-house decision as to whether or not to expand into the tile market.

Explanation: The Business Research Bureau is assisting Dakota Granite of Milbank in exploring the market feasibility of their product in the granite tile market. Europeans have employed new technology in the last two years for cutting and polishing granite. A single machine, which costs roughly $1 million, moves quarry stone from rough cut to finished product ready for shipment. Dakota Granite is considering purchase of one to three such European machines.

DAKOTA STATE COLLEGE

1. Utilization of DSC Small Business Institute as SBIR Information Center

Budget ---$27,000
Completion Date ---9/30/1988

Trends and Accomplishments:

- 0 The SBIR Center has been established and is functioning with DSC support and microcomputer equipment.
- 0 Approximately 125 persons participated in the December 2 SBIR Seminar.
- 0 Ongoing contacts with entrepreneurs and small businesses and industries will provide verbal support in applying for SBIR or federal monies.
- 0 There appears to be direct benefits to networking with regional federal agency managers.

Explanation: This grant was to help with the expansion and development of the Small Business Institute at Dakota State College as a site for dissemination of information related to SBIR (Small Business Innovative Research) grant possibilities. The SBI was to become a part of a national network of SBIR information dissemination and is to provide distribution of materials to businesses and industries and make direct contact to encourage small industries to apply.

BLACK HILLS STATE COLLEGE

1. Geothermal Resources (Cooperation with SDSM&T)

(See Geothermal Resources In Western South Dakota listed under South Dakota School of Mines and Technology.)

NORTHERN STATE COLLEGE

1. Northeastern South Dakota Rural Development Resource Center(RDRC)

Budget ---$15,500
Completion Date ---July, 1988

Trends and Accomplishments:

- 0 Survey had a 40 percent return rate which was good.
- 0 Community elected to explore attracting a clothing store to Clark. A market for such has been determined to be in existence and will support a clothing store.
- 0 Recruitment of an owner/operator for the store is well underway. At least two prospects are currently in the clothing store business.
- 0 Sufficient response to the project has been generated to create a reasonable expectation of the start-up of such a business this spring or summer.
- 0 Due to greater than expected assistance from the community and Northwestern Public Service Company, it is expected that 50 percent of the funds allowed will be returned to the Future Fund.

Explanation: This pilot project was to identify businesses which are needed in the community of Clark, verify their viability and then actively seek out an owner/operator to start the new business. The faculty at Northern State College is providing technical assistance, working with the Clark Industrial Development Corporation and Northwestern Public Service Company on this project. It is a four-phase project: survey phase, community preparation phase, recruitment phase, start-up phase. It is hoped that techniques developed with the Clark project will be applicable in other similar communities.

2. Dakotah, Inc.

Budget ---$10,500
Completion Date ---fall, 1988

Trends and Accomplishments:

- 0 This project is still in its start-up phase. It was not expected to get into full swing until the spring of 1988.
- 0 Several meetings and informative discussions have taken place between Dakotah, Inc. executives and John Meyer of NSC.
- 0 NSC faculty have been selected for consulting services during the spring and summer.
- 0 Assessment has been made as to the possibility of a franchise operation for Dakotah, Inc. It would, among other things, improve profit potential and allow faster growth and expansion.

0 The advantages and disadvantages with the present Dakotah marketing plan have been compared.

Explanation: Joint research by Northern State College and Dakotah, Inc., of Webster is taking place aimed at doubling sales and profitability within the next five years at Dakotah. Dakotah has over 400 employee/owners working in seven factories in Northeast South Dakota. With 1987 sales of $15.7 million, Dakotah has become one of the most successful firms in its market and one of the largest U.S. manufacturing worker-owned enterprises. NSC faculty is providing specialized legal, marketing survey and strategic planning skills to help Dakotah with a number of potential products and projects.

APPENDIX

STATE OF SOUTH DAKOTA

GEORGE S. MICKELSON
GOVERNOR

EXECUTIVE OFFICE
STATE CAPITOL BUILDING
PIERRE, SOUTH DAKOTA 57501

(605) 773-3212

FOR IMMEDIATE RELEASE
FRIDAY, JANUARY 8, 1988

POTENTIAL MARKET EXISTS WORLDWIDE FOR CHLORINATION GOLD RECOVERY UNITS

PIERRE -- Experimental South Dakota scrap gold recovery units that use a special high temperature chlorination process may find their way into world-wide markets, according to Governor George S. Mickelson.

The units are part of a research project by the South Dakota School of Mines and Technology and the Chlor-Pure Corporation of Rapid City.

The project was one of 14 funded last summer by a new fund called the "Employer's Investment in South Dakota's Future" created during the 1987 legislative session. The fund was created by Governor Mickelson and the State Legislature using the formula from the Unemployment Insurance Fund. Employers from across the state delayed a decrease in their contributions so that the fund could be established. Its intent is to encourage research-related activities at state colleges and universities and help with the state's economic and job development effort.

"The early results of the gold scrap chlorination research are so favorable that Chlor-Pure has entered into negotiations with a firm that will market the new manufactured and licensed units worldwide," Governor Mickelson said.

-more-

"The research was one of the first we announced for funding by the Future Fund. it is gratifying to see such good early returns on the investments we made -- investments to stimulate economic development and research through state-supported institutions of higher learning."

The potential for the units and the chlorine process for extraction of metal and high purity compounds was spelled out in an interim progress report to the Governor this week.

Research indicates that 1) gold scrap from Black Hills gold jewelry manufacturing can be easily refined by chlorination; and that 2) gold, arsenic and mercury can be removed from Whitewood Creek tailings placer deposits by chlorination. Arsenic and mercury currently pose considerable problems when using conventional means of reclamation. Finally, 3) purity levels of gold recovered from the scraps run in excess of 99 percent.

Tailings placer deposits in Whitewood Creek are a consequence of 100 years of discharge of mill tailings from the Lead-Deadwood area and are classified for removal under a U.S. Environmental Protection Agency superfund program. Although gold grades are marginal, the chlorination process has the advantage of producing gold concentrates and arsenic concentrates, thus removing the major toxic element from the environment.

Researchers noted that while iron formation-hosed (Homestake-type) deposits are suitable for chlorination extraction technology, the Homestake deposit in Lead has an established processing plant and it is unlikely that the firm will consider using the process at this time.

-more-

The economic potential of small iron formation-hosted deposits in the Rochford area, however, may be enhanced by a portable chlorination plant.

The research-funded portion of the chlorination technology project is not expected to be completed until the end of August.

Additional technical information on the chlorination extraction project may be obtained by contacting Dr. S.L. Iyer, director of the Center for Innovation, Technology and Enterprise (CITE), SDSM&T, Rapid City.

-30-

STATE OF SOUTH DAKOTA

GEORGE S. MICKELSON
GOVERNOR

EXECUTIVE OFFICE
STATE CAPITOL BUILDING
PIERRE, SOUTH DAKOTA 57501

(605) 773-3212

FOR IMMEDIATE RELEASE
FRIDAY, JANUARY 8, 1988

RESEARCH GRANT LEADS TO WOOD PROCESSING PLANT IN RAPID CITY

PIERRE -- Grant money from the "Employer's Investment in South Dakota's Future Fund" has enabled a Rapid City firm to move forward with plans for a wood processing plant as early as February, 1988, according to Governor George S. Mickelson.

The fund was created by Governor Mickelson and the State Legislature using the formula from the Unemployment Insurance Fund. Employers from across the state delayed a decrease in their contributions so that the fund could be established. Its intent is to encourage research-related activities at state colleges and universities and help with the state's economic and job development effort.

Governor Mickelson said South Dakota Forest Products, Inc., aims to have in operation at that time a prototype plant capable of processing 1.5 million board feet.

The plant will use the new Gainsan method of staining wood, developed at the South Dakota School of Mines and Technology (SDSM&T) in Rapid City.

The process is a method of enhancing the color of softwoods with total color penetration of the wood. The treatment enables a

-more-

softwood, like pine, to look and perform like more expensive hardwoods.

Patent applications were filed and assigned to the SDSM&T Foundation Research Center, Inc. Because South Dakota Forest Products is a privately owned corporation formed solely for the manufacture of the wood stained by the new Gainsan process, the company will be required to pay a royalty to the South Dakota School of Mines and Technology.

"The principles of the process alone are exciting," Governor Mickelson said. "What was said when we awarded the research grant still holds: that the potential for the Gainsan process to have a positive impact on job creation in South Dakota is tremendous."

The portion of the research project covered by the $85,000 Future Fund research grant awarded in early September is not expected to be completed until the summer of 1988.

An interim report received by the Governor this week noted that studies have been completed on 1) toxicity; 2) thermal transmission properties of Gainsan wood; 3) fire retardancy; and 4) chemical composition.

Research has revealed that Gainsan treated pine is essentially non-toxic to fish and definitely less toxic than untreated pine. Gainsan treated pine also has 25 percent more insulating value over untreated pine.

It has been determined that Gainsan treated pine varies little from untreated pine on fire retardancy at present. Studies, however, are underway on a further treatment with known retardant chemicals.

-more-

Studies are also continuing on 1) environmental aspects; 2) improving the economics of the process; and 3) use of other soft woods in the Gainsan process.

Additional information on the Gainsan project may be obtained from Roland Dolly, director of Enterprise Initiation, Governor's Office of Economic Development, Pierre; or from Dr. S.L. Iyer, director of the Center for Innovation, Technology and Enterprise (CITE), SDSM&T, Rapid City.

-30-

STATE OF SOUTH DAKOTA

GEORGE S. MICKELSON
GOVERNOR

EXECUTIVE OFFICE
STATE CAPITOL BUILDING
PIERRE, SOUTH DAKOTA 57501

(605) 773-3212

FOR IMMEDIATE RELEASE
FRIDAY, JANUARY 8, 1988

RESEARCH MAY SAVE STATE'S
TROUBLED MUSHROOM INDUSTRY

PIERRE -- Research funded through South Dakota's new Future Fund is providing positive answers to problems and may save the troubled mushroom industry in South Dakota, according to Governor George S. Mickelson.

"Researchers have moved quickly from working with a set of problems to working with a set of solutions which will reduce production costs and processing time while increasing mushroom yields," he said.

The project was funded through the Employers' Investment in South Dakota's Future Fund. The fund was created by Governor Mickelson and the State Legislature using the formula from the Unemployment Insurance Fund. Employers from across the state delayed a decrease in their contributions so that the fund could be established. Its intent is to encourage research-related activities at state colleges and universities and help with the state's economic and job development effort.

The $37,000 grant was made to SDSU when Elkton Mushroom, Inc., reorganized under Chapter 11 bankruptcy laws. As part of that

-more-

reorganization, the business approached SDSU for assistance in solving technical production problems which were subsequently traced to the firm's past technical consultants. The result of those problems was the production of poor quality compost which growers refused to purchase.

Mushroom compost is a microbially and chemically treated mixture of agricultural byproducts and residues that has the proper physical, biological and nutritional properties needed to grow mushrooms.

At its peak, EMI sold compost to 91 local growers who produced 30,000 pounds of mushrooms per week and sold them in five states. Over 250 new jobs were created by this industry.

Researchers at South Dakota State University say chemical analyses of raw materials and resulting changes in mushroom compost formulation are reducing production costs from $10 per bag to $6 per bag, while increasing mushroom yields from five to 10 pounds per bag to 12 to 20 pounds per bag.

In addition, increased attention to proper mixing, watering and ventilation has reduced processing time from 30 days to 10 days.

These changes have improved process efficiency, reduced energy costs and allowed Quality Compost (formerly called Elkton Mushroom, Inc.) to reduce energy bills from $8,000 to $1,000 per month. The changes are also expected to increase the life expectancy of the plant.

Additional technical information on the project may be obtained by contacting Paul Nordstrom, director of the Center for Innovation, Technology and Enterprise (CITE), SDSU, Brookings, S.D., or Roland Dolly, director of Enterprise Initiation for the Governor's Office of Economic Development, Pierre.

-30-

STATE OF SOUTH DAKOTA

GEORGE S. MICKELSON
GOVERNOR

EXECUTIVE OFFICE
STATE CAPITOL BUILDING
PIERRE, SOUTH DAKOTA 57501

(605) 773-3212

FOR IMMEDIATE RELEASE
FRIDAY, JANUARY 8, 1988

CLARK RESEARCH PROJECT MAY RESULT IN NEW CLOTHING FIRM

PIERRE -- Residents of Clark, a northeastern South Dakota community, can expect a new retail clothing store this spring or summer, according to Governor George S. Mickelson.

Governor Mickelson said an interim report on one of 14 research projects funded through the State's new Employer's Investment in South Dakota's Future Fund indicates a new store may open in Clark as a result of community effort and a joint research grant.

The Future Fund was created by Governor Mickelson and the State Legislature using the formula from the Unemployment Insurance Fund. Employers from across the state delayed a decrease in their contributions so that the fund could be established. Its intent is to encourage research-related activities at state colleges and universities and help with the state's economic and job development effort.

"The Clark community leaders have been very active in an effort to keep its Main Street growing," Governor Mickelson said. "I am committed to fostering this kind of spirit which is making economic development work in South Dakota."

-more-

The community project to find a business for Clark was funded in part by a $15,500 grant from the Future Fund. Northwestern Public Service (NWPS) also provided funds and executive talent, leading a strong community effort to secure a new business.

NWPS and Northern State College were active in securing the pilot business project in Clark.

Dr. Hillar Neuman, Jr., an econometrician at NSC, received funds from NWPS to design a survey and to perform statistical analysis of data to help match Clark's needs and strengths with potential businesses. He identified types of businesses that could find local markets in Clark.

Money from the Future Fund has been used to assist in negotiation with prospective store owners and operators. The community currently has two prospects.

The final stage of the project includes the actual start-up of the clothing store. The Clark community has constructed a financial package to reduce start-up and operating costs for the new enterprise. It includes tax breaks, rental discounts, professional discounts and discounts on financial and legal advice.

Additional technical information on the Clark project may be obtained from John Meyers, director of the Center for Innovation, Technology and Enterprise (CITE), Northern State College, Aberdeen, S.D.

-30-

STATE OF SOUTH DAKOTA

GEORGE S. MICKELSON
GOVERNOR

EXECUTIVE OFFICE
STATE CAPITOL BUILDING
PIERRE, SOUTH DAKOTA 57501

(605) 773-3212

FOR IMMEDIATE RELEASE
FRIDAY, JANUARY 8, 1988

RESEARCH DOLLARS ENABLE DSC TO MATCH GRANTS WITH BUSINESS

PIERRE -- Governor George S. Mickelson says that research dollars used to establish the Small Business Institute at Dakota State College (DSC) will link businesses and grant opportunities in South Dakota.

One of 14 research proposals authorized in August and September from the Employer's Investment in South Dakota's Future Fund, the project's main thrust has been to make possible the dissemination of information regarding Small Business Innovative Research (SBIR).

"SBIR grants have been almost an untapped resource for South Dakota businesspeople," Governor Mickelson said.

The SBIR program allocates funding from federal agencies for research and development to small businesses across the nation. Since the program's inception in 1983, more than $1 billion has been distributed.

The Small Business Institute at DSC has been active in its early months of existence. In December, the center hosted an SBIR seminar attended by 125 persons needing more information on how to attain SBIR grants.

Small business owners have begun to network SBIR and economic development information.

-more-

The Employers' Investment in South Dakota's Future Fund was created by Governor Mickelson and the State Legislature using the formula from the Unemployment Insurance Fund. Employers from across the state delayed a decrease in their contributions so that the fund could be established. Its intent is to encourage research-related activities at state colleges and universities and help with the state's economic and job development effort.

For additional technical information on the Dakota State College project, interested persons may contact Faye Kann, director of the Center for Innovation, Technology and Enterprise (CITE), DSC, Madison, S.D., or Roland Dolly, director of Enterprise Initiation in the Governor's Office of Economic Development, Pierre.

-30-

STATE OF SOUTH DAKOTA
EXECUTIVE OFFICE
STATE CAPITOL BUILDING
PIERRE, SOUTH DAKOTA 57501

GEORGE S. MICKELSON
GOVERNOR

(605) 773-3212

FOR IMMEDIATE RELEASE
FRIDAY, JANUARY 8, 1988

RESEARCH PROJECT RESULTS
IN AEROSPACE BUSINESS CONTACTS

PIERRE -- Governor George S. Mickelson says an effort at South Dakota State University to develop a process to land aerospace business for South Dakota firms may be making progress.

"We have taken the initiative and are establishing contacts with various aerospace prime contractors and agencies to spur economic development and job creation in South Dakota," he said.

The effort is a result of a $42,638 proposal funded in September 1987 by the new Employers' Investment in South Dakota's Future Fund. The fund was created by Governor Mickelson and the State Legislature using the formula from the Unemployment Insurance Fund. Employers from across the state delayed a decrease in their contributions so that the fund could be established. Its intent is to encourage research-related activities at state colleges and universities and help with the state's economic and job development effort.

Contacts under this project have been identified in Dallas, San Diego, Indianapolis, and Dayton, Ohio. These areas are considered to be prime aerospace company locations.

Governor Mickelson said several consultants of the aerospace industry in Texas, Arizona, and Ohio have agreed to be economic

-more-

development representatives for South Dakota and are already providing valuable information for aerospace contracts.

A database is currently being developed by SDSU faculty members so that developing opportunities can be matched with manufacturer capabilities.

Field visits have been made to contractors and defense logistics agencies under the program. "The field visits resulted in considerable information which South Dakota manufacturers must assimilate and implement to attain bids," Governor Mickelson said. "So far, the reaction from many small companies is a feeling of being overwhelmed and awe-struck when first confronted with the information. They are hesitant to implement the necessary effort."

The Governor said that the next phase of the project includes helping South Dakota firms learn the process of working with the aerospace industry and assist them with understanding military specifications.

Additional information on the aerospace project can be obtained from Roland Dolly, director of Enterprise Initiation in the Governor's Office of Economic Development, Pierre; or Paul Nordstrom, director of the Center for Innovation, Technology and Enterprise (CITE), SDSU, Brookings, S.D.

-30-

STATE OF SOUTH DAKOTA

GEORGE S. MICKELSON
GOVERNOR

EXECUTIVE OFFICE
STATE CAPITOL BUILDING
PIERRE, SOUTH DAKOTA 57501

(605) 773-3212

FOR IMMEDIATE RELEASE
FRIDAY, JANUARY 8, 1988

RESEARCH DETERMINES NATIONWIDE DEMAND, MARKETABILITY OF NATIVE GRASSES

PIERRE -- A research project underway is searching for a market for South Dakota's native grasses, sedges and rushes for use in dried floral arrangements, according to Governor George S. Mickelson.

The project is one of 14 funded last summer by the "Employers' Investment in South Dakota's Future Fund. The fund was created by Governor Mickelson and the State Legislature using the formula from the Unemployment Insurance Fund. Employers from across the state delayed a decrease in their contributions so that the fund could be established. Its intent is to encourage research-related activities at state colleges and universities and help with the state's economic and job development effort.

The native grasses project was funded in August of 1987 to the tune of $10,461 and is being conducted by the faculty at South Dakota State University (SDSU). It will be completed this month.

Currently, many dried plant materials sold in florist shops are imported to South Dakota from other states. Research findings so far indicate interest in the product is not restricted to a particular geographical region, however, and the east coast may be the most profitable region to seek buyers.

-more-

A survey revealed that at least 60 percent of those who responded are interested in purchasing the products at a price of between $2 and $6. A product sample was included with all surveys issued. The quality of the products was rated high by most of the respondents.

The research included products grown on land not suitable for production of conventional crops. Researchers determined that plant species that stabilize soils and protect water quality would be even more useful and valuable if marketable products other than forage could be obtained from them.

Additional technical information on the native grasses research can be obtained from Paul Nordstrom, director of the Center for Innovation, Technology and Enterprise (CITE), SDSU, Brookings, S.D., or by contacting Roland Dolly, director of Enterprise Initiation for the Governor's Office of Economic Development, Pierre.

-30-

Senator **Sarbanes**. Thank you very much, Ms. McClure.

Two colleagues of ours from the House who were to testify at the outset and weren't able to be here are now here. I know they have other conflicting requirements and so I'm going to interrupt the panel for just a few moments to hear briefly from them—Congressman Wes Watkins and Congressman Jim Jontz. You can take the seats at the far end, I think, and we can hear you from there and we won't have to interrupt or displace the panel.

I know you've both been very active in the Rural Caucus in the House and provided considerable leadership. In fact, Congressman Watkins has been the Chair of the Rural Caucus in the House, and we're very pleased to have both of you here this morning. We'd be happy to hear from you now.

STATEMENT OF HON. WES WATKINS, A U.S. REPRESENTATIVE IN CONGRESS FROM THE THIRD CONGRESSIONAL DISTRICT OF THE STATE OF OKLAHOMA

Representative **Watkins**. Thank you, Mr. Chairman.

Senator Daschle, I know you have to leave, but I'll leave this testimony so you can read all of it later. [Laughter.] I hope that my words here are not accepted just as a colleague from the House or the Senate, but one as from a background of being a product of an economically depressed rural area of southeast Oklahoma. And, really, the motivating factor of my entering public life.

And I'd like to ask unanimous consent that my entire prepared statement be made part of the record, but I'd like to summarize it now, if I may.

Not only am I a product of an economically depressed rural area of southeast Oklahoma that has had five decades of outmigration of our young people from that area, again, it's the motivating factor. Including myself migrating to California three times right after World War II with my family in search for a job.

It made a burning imprint on my life.

We also have a chronic, long-term double-digit unemployment in that region of the State of Oklahoma, and also the highest food stamp and welfare area of the State and including the low income throughout, as high as 25 to 27 percent of the people living in poverty.

It's not something that happened overnight. It's something that has been there. We all know what's happened in the last 6 years. It's been frustrating to me to see 74 percent of the dollars cut in rural economic development programs during this last 6-year period.

Over 50 percent in rural housing, at a time when we really needed to make investments in trying to turn around this tide, programs were being cut. And I serve on the House Appropriations Subcommittee on Agriculture and Rural Development.

I'd like to also point out that my background's agriculture. I have two degrees, nearly three degrees, in agriculture. But what I'm going to talk about is rural America. And rural America is agriculture, but it's more than agriculture. It's 2.3 million people living out on the farm. Only about 2.2 percent of our population. But there's approximately 50 million people living throughout America in communities of 20,000 and less.

So I want to point out these things and know most of us know those facts. But what I'm here to say, with an agriculture background, we must build off farm jobs if we're going to save the very fiber of rural America.

I helped write the economic development programs of this nation. Years ago before coming to Congress, 20 something years ago, I literally got into economic development in this area I just described because it motivated Olympia and me back then, long before I ever entered politics, because I wanted to turn this economically depressed rural area around.

The point I want to make. I didn't come in on a load of watermelons last night preaching the gospel of rural economic development. It's my life. It has motivated me. And I've been frustrated because it seemed like I couldn't get the job done in the U.S. Congress.

Let me tell you what I would recommend. We know the problems. We know that something has to be done if we're going to save this way of life, because we know what has happened with 620,000 farmers leaving just during this last 6 years.

Let me give you certain points. I think logic can take over. As I try to build industry in my area—and let me say I have 16 percent of the population. There are six Congressmen in Oklahoma. I have 16 percent of the population.

But I'm proud of the fact, in that area I just described, those economic depressed conditions, last year, we built 37 percent of the jobs. And the year before that, 1986, we built 34 percent of the jobs.

That wasn't by accident. That was literally by hard work and planning and investing. You can find commitment. You can find commitment and you can weigh it and measure it on the amount of time, the amount of effort and the amount that you invest if you believe in something and you want to turn it around.

That's what you can find.

Well, let me talk about one of the most crucial things: financing. Economic rural depressed area, that's a common characteristic in every rural economic depressed area of this nation: financing.

Let me give you an example of that southeast part of the State of Oklahoma. Oklahoma City and Tulsa are not interested in putting money in areas 200 miles from their center. They could put all the money they want to in a 15-mile radius.

We've also had 81 banks close in Oklahoma and I know in the areas of the heartland of America that's a common characteristic of every State.

But the big city banks are not interested in loaning money 100 to 200 miles away. Financing is the lifeblood, it's the blood to try to revitalize rural America.

I put together some reviving money this past year; we have underwritten nearly $13 million in new industry with just some gap financing and some ways to work with industry, showing the posit characteristics that are needed and can be provided.

For instance, we have the work ethic. People want to stay out there on the farm. They'll work in textiles. And believe me, I've done a program called "Don't overlook rural America as you look overseas to locate your plants, because we'll work even for less in rural America in order to try to get the job."

But we have to have financing. Infrastructure. I'm working to build magnet or growth cities in my area. Why?

One of the most important things is to provide an industrial airport. Chief executives—common sense—chief executives do not want to fly to Oklahoma City, a metropolitan area, and then drive 3 hours to the rural area.

We have to have an infrastructure of industrial air parks so the chief executives can fly right into that rural area and in that rural area they can get out of their plane and walk over to their industry if they're going to locate a plant there to help that area survive.

As Senator Symms said, we need set-asides for procurement, but set-asides in other programs, just as we have for minority areas, we need set-asides for rural areas of this nation if we're going to turn it around.

I'd like to ask the chairman and members of the committee to reflect with me on two or three suggestions I'm going to make also.

For instance, there's some things we can do if we want to save rural America. We can show that we have a priority for it.

For instance, we got HUD, Housing and Urban Development. I have recommended through legislation and I'd like to see that maybe this committee might recommend it, that we have a change in USDA to Agriculture and Rural Development. I don't have anything wrong with urban development, but let's—the USDA has the mandate for rural development.

But they are not structured to carry out that mandate. And I've tried to provide legislation also to restructure the USDA so there is a clear mainstream flow for rural development in America. We don't have that today and we cannot carry it out if we wanted to.

One other thing I've suggested and would like for you all to reflect on it with me:

Just as the Hatch Act in 1887 established Agriculture Research, basically, the land-grant universities that came in in 1890, it served us well in production research, but nowhere have we over the years provided the same research center, so to speak, for business and industrial technology development.

We set up out in the land-grant universities agriculture research centers, and from those ag research centers, we had ag teachers and extension agents doing technology transfer work in agriculture production.

I was taught as a farm boy to grow four blades of grass in the place of one. And we did it. We've done it.

Now I say in the recommendation I made to legislation that we set up high-tech industrial innovation research centers that are land-grant universities, place some new roles and new responsibilities in the additional funding to extension, to broaden their roles—not just for agriculture technology, but to work with every business and industry to be technology transfer agents working with those businesses and industries out across rural America.

We have locations in every county in America. They can broaden and they must broaden their roles or responsibility if they're going to exist in the next decade.

And I think they can be trained in a matter of a few short courses to start working with business and industry on technology transfer that would plug back into our land-grant universities, into that high-tech research center, to start transferring that technology from Federal laboratories, from the R&D Fortune 500 industries, and the other particular, nonprofit groups across the country.

So I share those suggestions. That will be a quick summary of my prepared statement. I didn't come to just name the problems. Most of us know what the problems are; I think you're looking for some solutions.

And from my experience long before I got into Congress, these are some of the practical, tangible solutions that I would suggest that we implement if we're serious, if we're dead serious about changing the economic outmigration from rural America and economic conditions of rural America.

Thank you, Mr. Chairman and members of this panel.

[The prepared statement of Representative Watkins follows:]

PREPARED STATEMENT OF HON. WES WATKINS

Mr. Chairman, thank you for allowing me this opportunity to share with this Committee a few of my thoughts on a favorite subject of twelve years in the Congress -- rural development. Rural economic job development was a principal concern of mine even before coming to the Congress.

I served as the director of one of the first sub-state economic planning districts in the nation. Later, when I found that one of the components missing to industrializing these areas was having adequate housing, I became a rural homebuilder. My committment to rural development was challenged when I became a homebuilder in the rural areas of Oklahoma. Needless to say, I had to build homes primarily through the FmHA program because other financing was not available. The FmHA rural housing and other programs have been a salvation for rural areas.

There is not a better or more timely topic that this Committee could address than Rural Development in the 1990's. Rural development is a key to many of the 2.3 million farmers being able to survive in an economic climate that no longer allows him to depend upon resources returned from the farm. I dare say that if we would have had a rural development policy in place that since 1985, 235,000 family sized farmers would not have been forced from the land. Since 1981, we've lost 620,000 farmers -- one fifth of all American farmers off the land.

Rural development must be considered as a component in the next farm bill debate if as a nation we are to have a dependable, static level of family farmers that are able to produce good quality food at affordable prices. I would venture one step further to say that it is in the interest of national security. **Off-farm jobs is the key to the survival of many family farmers.**

And, then there is the human component to the loss of family farmers.

Unlike many of their urban cousins, they must pluck their family from the land away from family and friends to be relocated in another area of the country. This is not by choice. It is a decision that is made for them because there are no jobs available in rural America.

My committment to rural development begain at a very early age when my family packed all they had and headed west on highway 66 to California -- in search of jobs and a better way of life. It was trip that was made three times. The jobs were temporary but, the effects of such a move was permanent. The move and job related pressures split my family to never be put back together again. Highway 66 was our Trail of Tears those days, Interstates 35, 40, and 44 are ours today as Oklahomans leave the state in record numbers because of the lack of jobs in rural areas.

Without a committed policy and the needed resources and investment toward rural development, as a nation, family farmers are not the only thing that is lost -- but a way of life. While there are only 2.3 million American farmers left, there are over **50 million** Americans that live in communities of less than **20,000 population** -- rural areas as defined by the Department of Agriculture.

This country was founded on hope, opportunity and a family-centered environment. Without a policy to say that this should continue, the fabric of this country -- the family -- is being ripped apart by the threads. When do we say that we have had enough and enact legislation to establish a national rural development policy?

As a result of present federal policies, a **74 percent** reduction in funds has occurred for rural development programs in the Department of Agriculture alone. Federal funding for rural housing has been reduced by **50 percent.** Yet, the need for investment and attention to rural development has never been greater for main street rural America.

Having worked in rural economic development for most of my life, I am the first to realize that a myriad of tools and economic incentives to assist must be used when private capital is not available or unwilling to make such investments in rural areas. A comprehensive "Marshall Plan" is needed to rebuild rural America such as that used to rebuild Europe following World War II.

Rural people are willing to work and given an employer and honest days work for a day's pay. Last month, with the help of Farmers Home Administration loan guarantees, fourteen direct new jobs were created with the addition of a plant in my area. An additional 100 jobs related to the plant will be created. The point I want to make is that almost 450 people applied for the 14 jobs that the plant created.

Most rural areas will never land the large automoble manufacturing plants or similar plants with large magnitude. Our focus for rural areas should be on those businesses and industry that can provide 100 or less jobs or even 50. It has been documented that most new businesses average less than 15 employees and make up the largest sector of new industry each year in the country.

But there are some real deterrents -- as evidenced by your panels today -- infrastructure and financing are two of them. Let's take a look at the problems as well as the things that need to be done to assist rural areas.

--**Financing** is probably the most important item that can be identified that is lacking in a rural area. My congressional district which is comprised of twenty rural counties with most cities 20,000 or less -- most much less is lacking of financing and infrastructure and typical of most isolated rural areas. When I have tried to get bankers from Oklahoma City and Tulsa to make investments in our area they refused. This was too far from their urban environment to look after the collateral. By the same token, bankers from Dallas and Fort Worth are not willing to cross the Red River and make investment in a capital deprived rural area for much the same reason. Local hometown bankers neither have the experience or the capital to assist in large economic development private sector projects.

After repeated efforts to obtain necessary financing from larger banks in metropolitan areas as well as local banks, a piecemeal approach to financing an entity through various government contracts to lend money in rural areas was put together. Last year, the entity provided $12 million in capital for investment in jobs producing industries in Southeast Oklahoma and was responsible for creating about 480 jobs.

Today, the entity has identified nine different companies with capital needs of $8.3 million for the startup of new businesses or expansion of existing businesses which would result in the creation and retention of 419 jobs. Without some mechanism for rural industrial financing, rural areas will continue to die from capital malnutrition. Had the mechanism for delivering the gap financing not been in place, the Third District would have lost those 480 jobs last year.

--**Infrastructure**, important to economic/industrial development, has become antiquated and in some cases has deteriorated beyond repair in rural areas. And, I might add many key areas are without. A national focus should be directed to the repair and replacement of rural water systems, treatment facilities, highways, bridges, water transportation facilities and other such necessary public purpose facilities which are integral to commerce, tourism and economic development.

Industry will not come to rural areas if at least the basics of education, health care, housing and other infrastructure are retained or put into place. In my rural area, schools continue to be consolidated while hospitals close as a result of an inequitable manner of paying rural hospitals for medicare. The Congress has begun to take a look at the rural-urban medicare payment discrepency but more remains to be done. Rural areas can never be considered for rural industrial job development without at least the essentials.

--**Action rural development program funding** (FmHA, EDA, UDAGs, CDBGs, etc.) must be targeted to those rural areas most in distress or in need of revitalization. Appropriations committees must direct funding in the high priority areas as new or redirected funding becomes available from other programs and reduced farm program costs.

--**Modern Growth Area Industrial Parks** should be given priority status for federal financial assistance in such rural distressed areas. Federal financial assistance programs through FmHA, SBA, EDA, and others should be strengthened and directed to the development of such industrial parks. These parks should be developed comprehensively to include airport, rail, and major highway access. Rural industrial incubators for startup businesses should be located in industrial parks or near Vocational-Technical skills training centers.

Why are Modern Growth Area Industrial Parks needed? Chief Executive Officers are not willing to fly into Dallas or Oklahoma City and drive two to three hours to get to a plant. When they land at an airport, they must be within 15-20 minutes driving time of the companies plant. The CEO could fly into one of these parks where he or she will be only minutes from a plant or a particular prospective building site.

Not every rural community will have everything but, in the beginning through the development of Modern Growth Centers in communities with immediate potential then rural residents can commute to these hubs for jobs. The hubs will serve as magnet towns to fuel the local economies of even smaller communities and with additional development can exand to these smaller communities.

--Legislation must be passed to recognize the role that the Department of Agriculture has is more than production of agriculture. It is also mandated to do rural economic development. This may be accomplished by **restructuring the Department** to include a division for rural development and renaming the Department to the Department of Agriculture and Rural Development.

--Legislation should be passed to bring the Economic Development

Administration under the Department of Agriculture since this would more accurately reflect the role and mission the agency has in service.

--**Establish local revolving funds** for economic development in economically distressed areas. These funds can provide capital that otherwise would not be available.

--**Earmarks or rural set-a-sides** to be provided in programs by Congress should be obtained and targeted to assist in the development of off-farm jobs.

--Work toward a **federal financing mechanism for assisting in the commercialization of new industrial products and processes** which use agricultural and forestry crops and further research funding for those products and processes which are on the threshold of commercialization.

--Federal financial programs such as SBA, EDA, UDAGs, etc. should be designed in conjunction with state/local financial programs in order to take full advantage of mutual leveraging and mezzanine financing packages.

--**Full federal tax-exempt financing and/or federal distressed guarantees** for crucial public purposes needs in rural distressed areas should be passed by the Congress.

--**Training programs** in conjunction with skill centers can be structured in cooperation with the Job Training Partnership funds and similar programs to deliver the kind of training programs that rural industry needs and desires.

--**High-Tech Industrial Research and Development Centers should be established at Land-grant colleges and universities to be directly linked with a modified and expanded role of the cooperative extension service** to meet the technology needs for new product development and new businesses and industry. The Center would be directly tied to the network of federal laboratories and available technologies and existing technology transfer efforts.

Assistance needed or new products and processes to be evaluated from local people at the county level would be transmitted back through the chain to the Center where a response would be generated. The Rural Economic Development Extension Service would take an active role working to meet the technology needs of business and industry and the creation and the creation of off-farm job opportunities that will result in needed economic growth for rural areas.

Land-grant colleges were established by the Morrill Act of 1890 with the objectives of providing education, research, and extension. The Land-grant agriculture research system was put into place with the passage of the Hatch Act of 1887. The technology from research is to this day being carried to rural areas through the Cooperative Extension Service established with the Smith-Lever Act of 1914.

While land-grant institutions and the cooperative extension service have performed their duties of education, research and extension well in production agriculture, the mission within must be broadened to effectively serve technology needs for expanding and developing rural business and industry.

These are but a few of the problems and solutions to those problems in rural America to stimulate the economies into producing off-farm jobs.

Eleven years ago when I came to the U.S. Congress, I placed a map of Oklahoma on my wall outlining the Third District with the economic and unemployment figures for each county. It is a daily reminder of my mission in Congress which is to make a positive difference in improving the economic conditions of the Third District.

Over the years, I have seen the unemployment figures go down but, as I discovered it was not of my doing. I found that the unemployment figures no longer take into account those discouraged workers. We have a greater task than the numbers indicate for all of American.

The theme I've taken to the citizens has been "Together -- we are building new opportunities". The thrust from my office and staff is to "make it happen" - to make that positive difference. I am convinced today more than ever that if we emphasize the potential not the poverty, the advantages not the disadvantages and possess a "can do" attitude with the willingness to invest the necessary time, effort and "seed" money, that positive economic changes will take place.

Our thrust has been to implement the most comprehensive "full court" economic development initiative possible to build new economic and job opportunities for our citizens. I know in our enthusiasm we will error, make mistakes and sometimes fail, but the biggest failure is to do nothing.

Figures from the Oklahoma Department of Commerce indicate that with only 16 percent of the population, the Third Congressional District created 37 percent of Oklahoma's new jobs in 1987 and 34 percent in 1986. Much of this economic turn-around is in counties that have traditionally been known for long-term welfare, low per-capita income, high unemployment and "out-migration" of the citizens who must leave for their economic survival. These results just don't happen, they are caused to happen. It takes a committed policy with policymakers willing to make an investment -- willing to make an investment in rural America. However, we must do more. It is time to develop a national policy on rural development that is consistent and adequately funded. There should not be a piecemeal funding method and policy toward rural development.

Rural Americans should have the choice whether they live and work in a rural area instead of an urban one. It should not be as this Administration has advised -- to vote with their feet. Their options have all been removed or vetoed. They have no other choice. When faced with pursuing a job elsewhere or leaving a rural area, hope is pursued in an urban area.

I have always believe that politics is not the end in itself but the means to an end. I hope this Committee shares that opinion and that my colleagues will endeavor to seek every opportunity to allow rural Americans to participate in the prosperity that the current Administration has talked about the last 8 years and that rural areas have yet to see. We have a responsibility to the people of rural areas to develop a national policy on rural development.

Mr. Chairman, thank you for allowing me the opportunity to present a statement before the Committee. I would be happy to respond to your questions.

Senator **Sarbanes**. Thank you very much, Congressman Watkins. We know the work you've been doing in this area and we're very appreciative to have your testimony. And, of course, the prepared statement will be included in the record.

Congressman Jontz, please proceed.

STATEMENT OF HON. JIM JONTZ, A U.S. REPRESENTATIVE IN CONGRESS FROM THE FIFTH CONGRESSIONAL DISTRICT OF THE STATE OF INDIANA

Representative **Jontz**. Thank you very much, Mr. Chairman. I want to thank you and also thank my colleague from the House, Congresswoman Snowe. This is my first opportunity to appear before this committee, and I certainly appreciate your hospitality.

I also want to thank the State legislators for their patience and acknowledge the outstanding leadership of my colleague, Wes Watkins. I certainly appreciate his leadership, as do all of us from rural areas. And I know your statement is going to add a lot to the record that will be considered by this committee.

Indiana's Fifth Congressional District, which I represent, is very typical of rural America, consisting largely of small communities interspersed by grain and livestock farms.

When I talk to my constituents about Indiana's future, they pose the question something like this:

What kind of jobs are there going to be in our small towns and our rural communities for our children?

Are there going to be good jobs here that pay a decent wage, where we can educate our young people, retire in some dignity, and where we can make a decent living?

The answer to that question isn't certain. And that's why this committee is holding these hearings: to see what we can do to ensure that rural development programs and opportunities are available in the Fifth Congressional District of Indiana and other rural districts across the country.

Undoubtedly, we do need to give a much higher priority in our budget to rural economic development programs. I do not believe that general government economic programs will always trickle down to rural communities. Obviously, there are infrastructure differences between rural and urban environments that require different approaches.

At the same time, however, I think we must look at existing government policies and programs to take advantage of opportunities which may exist to promote rural economic development without spending additional funds in many cases.

I would like to cite two examples that have come to my attention through my service on the House Agriculture Committee. Both of them illustrate instances of government policy that could be bringing us rural economic development, and which have not, unless corrected.

The first concerns a deficit reduction proposal mandated by the Congress. Last year, I became aware of a Farmers Home Administration plan to auction at a heavy discount a sizable proportion of its community facility loan portfolio to large financial institutions.

I asked the Farmers Home Administration if it would be possible to allow the communities that actually had the loans in our rural counties throughout the country to repurchase these loans at a similar discount through this program.

And I was refused by the Farmers Home Administration. This was despite the fact that these communities were not asking for any greater discount than was expected to be bid at auction by the banks.

We were successful in including language in the farm credit bill giving borrowers, these small towns, the opportunity to repurchase their community facilities loans at discount.

In my own State of Indiana, borrowers have already saved $54 million because of this option. My county seat, Monticello, IN, saved $809,000 on water and sewage loans that they have.

For some communities, the savings is less; but for others, the savings is more.

This is just one example of how rethinking a policy can greatly benefit rural communities and promote rural economic development without spending additional money. The savings that these towns have realized can then go for infrastructure development, to keep utility rates under control, or any number of other purposes which would attract new jobs in these communities.

The second policy area that I would like to address briefly is the need to redirect our existing policies concerning forest and wood products to promote new economic growth.

Studies have shown that private forest lands offer the greatest potential for profitable return on timber investment. Yet, increasingly, the Forest Service is using the scarce resources that are available to harvest timber on more remote sites on public lands that are inherently less and less productive.

The limited Forest Service budget that's available for landowners to aid in promoting sound forestry on the potentially more productive private lands has actually declined in recent years.

Funding for Forest Service programs to assist private landowners amounts to less than 3 percent of the total agency budget, 1987, and actual funding for management systems was only one-twelfth of that, less than $5 million.

Even that very modest sum was proposed for elimination by the President in his budget.

By redirecting our forest policies to take funds that are now being used to harvest public timber in remote, unproductive sites and use those funds to provide assistance to private landowners, where we could produce more timber and put money in the pockets of farmers and other local landlords, we could be getting a lot more economic development for the money that we are now expending; and at the same time, I might add, avoid some difficult conflicts that now exist in the management of Federal lands.

Federal land management policies must also pay greater attention of nonextractive programs. For instance, the Forest Service in many cases needs to do a better job recognizing the importance of non-timber-related jobs to area economies.

Current government policy may, in fact, work to the detriment of rural economic development by focusing so exclusively on timber harvests while decreasing the opportunities for economic development in areas of tourism or other nonconsumptive uses.

I feel confident that by rethinking Federal policies in a number of these areas, we can bring about greater economic development in rural communities.

I have done a considerable amount of work on this forest issue and would like to make available to the committee for its files a copy of a paper I delivered to the Society of American Forests last year.

But, the point I want to make is, in many cases, we can reorient existing programs and by spending no more money, get a greater return in rural economic development by thinking about the implications of the dollars that we spend.

I thank you very much, Mr. Chairman, for your kind attention to my statement this morning.

Senator **Sarbanes**. Well, we want to thank both of you for a very helpful contribution. I know the kind of schedule you're on and we're very pleased that you were able to be with us this morning.

Thank you very much.

[The prepared statement of Representative Jontz follows:]

PREPARED STATEMENT OF HON. JIM JONTZ

I appreciate this opportunity to testify before the Joint Economic Committee as it examines the issue of rural development in the 1990s.

Indiana's Fifth Congressional District, which I represent, is very typical of rural America, consisting largely of small to medium sized communities interspersed by corn and soybean farms.

I find that many of my constituents are very concerned about uncertain employment prospects for their children. They ask what can be done to ensure that there will be good jobs, paying good wages, that their son or daughter will be able to support a family on.

Undoubtedly we need to give a much higher priority to increasing rural economic development programs. I do not believe, for instance, that general government economic programs will effectively "trickle down" to rural communities. It is obvious that infrastructure differences between rural and urban environments require different approaches to economic development problems.

We must be willing to reallocate scarce resources to bring about increased rural economic development. However, we must also reorient our government policies. We do not necessarily need to always spend more - rather we need to spend more wisely.

I would like to cite two examples that draw on my service on the House Agriculture Committee. Both of them illustrate instances of inappropriate government policy.

The first concerns a deficit reduction proposal mandated by the Congress. Last year I became aware of a Farmers Home Administration plan to auction at a heavy discount a sizeable portion of its community facility loan portfolio to large financial institutions.

Many of these community facility loans are used for water treatment plants. Rural towns are often faced with paying for these facilities, required under federal law, without the means to do so. For instance, in one community of less than a thousand people a $3.4 million renovation of the community's wastewater treatment plant is required - despite the fact that the community's entire assessed value is approximately $2.7 million.

FmHA can lend the necessary money to construct such facilities. When I asked the FmHA to allow communities to repurchase these loans at a similar discount through the above mentioned loan asset sale program, I was refused. This was despite the fact that these communities were not asking for any greater a discount than was expected to be bid at auction.

I was successful in including language in the Agricultural Credit Act giving borrowers the opportunity to repurchase their community facilities loans at a discount. In my state of Indiana alone borrowers saved $54 million. For instance, Monticello, Indiana saved over $890,000, while St. John saved over $2.1 million.

This is just one example of how rethinking a policy can greatly benefit rural communities. This is money that can be used to provide for other infrastructure development, or to hold down utility rates - both of great importance in attracting new jobs to a community.

Another area that I am very interested in is redirecting our forest policy to promote new economic growth. Studies have shown that private forestlands offer the greatest potential for a profitable return on timber investment. Yet increasingly the Forest Service is using scarce resources to reach remote timber sites that are inherently less and less productive. The limited U.S. Forest Service budget for landowner assistance to aid in promoting sound forestry on these potentially productive lands has declined in recent years. Funding for Forest Service programs to assist private landowners amounted to less than 3% of the total agency budget in 1987. Actually, funding for management assistance was only one-twelfth of that -- less than $5 million. The President has tried to completely eliminate this program. I feel that by redirecting our government policy to provide greater assistance to private landowners we could provide new economic opportunity to rural America, while avoiding conflict in the management of federal lands.

Federal land management policies must also pay greater attention to the importance of non-extractive programs. For instance, the U.S. Forest Service needs to recognize the importance of nontimber related jobs to area economies. Current government policy may, in fact, be working to the determent of increasing rural economic development. Federal timber sales policies that seek to maintain or increase timber sale levels often work against the creation of new nontimber jobs. Clearly we must have greater balance in our federal policies.

I feel confident that by rethinking federal policy that it will be possible to realize greater economic development in rural communities without increasing government spending. In so doing, we will provide jobs for today's children, and for their children.

Senator SARBANES. Mr. Sims, we'll come back to you. We're sorry for the interruption, but I'm sure you understand.

Mr. SIMS. I certainly do, Mr. Chairman.

Senator SARBANES. And I simply want to acknowledge at the outset your long work in this field and my understanding that you represent the largest legislative district in the country, as I've been informed, covering some 68,000 square miles.

Mr. SIMS. Yes, sir, that's correct.

Senator SARBANES. Well, we'd be happy to hear from you.

Mr. SIMS. We have a lot of mountain lions and coyotes out there, too. [Laughter.]

STATEMENT OF HON. BILL SIMS, TEXAS STATE SENATOR

Mr. SIMS. Thank you. It's certainly a pleasure to be here. And when I read the chairman's letter, I read it to say that you wanted us to explain our problems in Texas, not to give you statistics. And so the statistics are history and certainly they're there to be read.

We also, as all legislators, are reactors. And we've reacted to the economic problems by forming many commissions, new commissions, to try to help. Actually, though, I think Lloyd Bentson hit it pretty well. He compared the Texas rural economy to a big hunk of Swiss cheese, recognizing that there are holes in the rural economy.

He makes a good comparision, but my question should be: Where is the cheese?

For the last 4 years, all we've seen in Texas are the holes. And rural Texas certainly has been a dominant factor in our State because we have a lot of it.

The crisis was fueled by inflation which caused farm income to go up at a fast pace. This made much more money available to the rural people and resided back into the land, and also this was all caused by the runaway energy prices.

So people say why do you worry about—why do you put so much importance on energy?

Well, energy in my district is extremely important. I think we produce something like 200 million barrels of oil. And, quite frankly, probably one-third of all agriculture producers in Texas are either directly or indirectly affected by energy.

We're either making leases; we have production; or we work for oil companies. We also receive very generous damages from the oil companies when they drill on us.

Oil production produces jobs—roughnecks, pumpers, roustabouts. During the 1950 drought, there were probably more cowboys working on oil rigs than there were riding horses.

And about half the people that I know in west Texas paid for their feed bill because they were working in energy or they were receiving leases and, hopefully, production.

Because of the high amount of energy money coming into the State of Texas, this has taken land values completely to the top. We saw land go from being worth $200 an acre to $500 to $600. And this can cause a lot of problems not only in your trying to buy a farm and ranch and make a living on it, but also it has a lot to do with yours schools and your other energies.

As farms, we cannot compete with labor that's used in the oil business; we can't pay that much money.

I am a fourth generation farmer and rancher. Our family came to west Texas in 1878, my grandfather was the first sheep producer, and we still produce sheep on the same ranch that he did.

Another important part of the oil-energy business has been the added emphasis that has been put on recreation. Texas being a public land State, we have the opportunity to make hunting leases to people and the oil companies felt like they were obligated to take everybody in the world hunting while they had money.

I'd like for you to realize that in Sutton County, TX, which is a heavy deer population and turkey and the Edwards Plateau, that they, the merchants in town, receive $65 a day from each hunter. That's not counting the rancher, that's just the merchants.

So, all of a sudden, in the Edwards Plateau, which is about 45 million acres, and much of my district is in there, we have a very important business in hunting. And because of the oil business—by 1980, we saw the inflation continue and we got into a real problem because our banks, all of a sudden, started making loans to anybody that could walk in the door.

The Federal Land Bank, the Texas Production Credits, and independent banks all made the mistake of loaning a bunch of money.

Another problem we had is that they loaned us money on inflated equity. And then, all of a sudden, they started wanting to get it back on cash-flow.

I don't know whether you've ever tried that or not, but it don't work worth a durn.

We are still making a lot of money. We still saw land values going higher. We still saw the dollar getting stronger overseas, and that caused weaker prices over here because we couldn't sell our products overseas. And so we started seeing this problem develop.

We couldn't sell products overseas, and inflation was high, then we had to pay the 20 percent interest.

This 20 percent interest I guess was meant for two things. One was to break farmers and ranchers and the other was to weaken the dollars overseas.

And it was very successful in both cases.

So what we saw in the early eighties was this oil business still just going wild. In 1984 was the beginning of the end of the boom. The next 3 years were almost as devastating to the real economy as the 1930's. What started as a decline, turned into a ruination of many people financially.

Young farm families saw their dreams dry up and blow away. It was like a quick death. It started in a small, festering sore and grew until it seemed that it consumed them and broke them in just a minute. With no way out but out. That's all they could do.

From 1982 to 1988, we lost something like 43,000 farmers and ranchers in Texas.

What happens? Places get bigger. And we're seeing that. The trend's going and it's going to keep getting bigger. And people keep saying, well, we have to have legislation to help the family farm.

Folks, just start worrying about all farmers. Let's don't worry just about the family farmer. Almost everybody I know is a family farmer. Their whole family is in it. They may own 100,000 acres, but it's still a family farm.

So, if we think that we can have agriculture by having a lot of little family farms who grow peanuts or something, we're not going to get it done.

We don't know what caused our problem. We don't know whether it was the interest—well, we do know that it had something to do with the 20 percent interest. I experienced the 20 percent interest, and you can't do it on agriculture and it busted a bunch of us. And people had to start looking at the different ways they were going.

It broke people not only in the oil business, but it broke the little, the small merchant in Lamesa, TX, or the small oil company in Midland, TX.

And we saw this also when our banks had made these bad energy loans. I guarantee you that there were several banks in our country that, if you could walk in and you looked like that you might have had a speck of oil on you, they'd loan you money, just so you could go get back in the energy business.

Well, it broke a bunch of banks. What happened was that, in Texas, just this last year, in 1987, we saw 50 banks go under—50.

In 1988, we've already seen 96. And it's because of the loaning—well, because the banks didn't use sound judgment. And I guess that's part of life. That's the way the Depression started.

Now, what should we do?

I don't know. There's two or three things that I'd like to—there's one or two things I want to say that we got a real problem. First of all, I would say Texas is doing pretty good now. We're leveling out, we're starting back up a little bit, we have new industry coming in. Rural development is going to prosper when agriculture prosper and then you'll come back to build little business.

But we're seeing more the oil industry is perking up. We've gotten rid of all the people that it took $40 a barrel or $20 a barrel to make a living. We're back down to the people who got into the oil business and knew what they were doing.

And so that's doing good. We're seeing some wildcat in there, which we haven't seen in 3 or 4 years and which is aboslutely necessary.

Well, I'm very optimistic. There's still two or three things that concern me. One of them is rural education.

Now, what we've done in Texas, it was not very wise, is, all of a sudden, we had a bunch of counties get a lot of money. And the school districts started prospering.

And then they started selling bonds and building new buildings. And now what has happened?

And also we had the production, we had the energy people coming into the towns and, well, you had booms of as much doubling in some of those towns. OK, now, those people are gone.

They voted a big bond to build a school and now they're not there to help pay the tax.

So what's going to happen in Texas?

We're going to see I think a real critical problem with our rural education because the taxation on the local districts is liable to kill them.

So it's a problem that we must face. Also, rural health is in the same situation exactly except the difference of course in rural health is, well, actually, it's not like schools because it's not as much supported. But, during the time that we had the gas, or that we had the good economy, oil and gas, and also good agriculture prices, we saw these hospitals get along.

They weren't doing great, but they were getting along.

Well, they've lost that today. We've lost as many as, let's see, three hospitals in 1981. We've lost 18 rural hosptials in 1988 as of today.

And what we're seeing is that the counties and the cities do not have the ability to pay for these services.

So this is going to mean in my district there may be 150 miles to a hospital.

I don't know what the Federal Government can do about it; the State can't do anything. But the Federal Government, I don't know how we can do it. Maybe we can get young doctors to go out to a place like this.

But, I would daresay that a young doctor that could make $500,000 in Houston, TX, would not be too excited about going to Marathon, TX, and making $50,000, if he could make $50,000.

So there's a real problem in Texas and I would suspect all over the United States in rural health. And it's like a cancer, you don't notice it because it's just eating them up and you lose another hospital and you lose another one.

I have two counties in my district that have county hospitals. One of them is supporting their district hospital to the tune of $500,000 a year and the other one is closer to $1 million a year.

So, because of the support of the oil industry, we all of a sudden are about to lose our—we built up good hospitals and then it went the other way.

Now, there is another problem that has really worried me, and I have worked on it many years. It is the farm bill and the support that Congress gives to the farmer.

I think we have some good programs, but we have a major problem. The wrong people are paying for it.

Senator Symms alluded to this. It is my opinion that we have a defense food program rather than a farm program, because if you do not have food you do not have a defense, and people can say what they want to and to me it is just like a cancer again. You can sit there with your head in the sand, and it is not going to get any better.

What is going to happen is the way agriculture is going we are losing producers. We have lost a lot of producers, and what we have lost, though, it is something that we are losing the farmer that is from 25 to 35, 25 to 35. Is that important? You bet, because in 20 years that person will be 55 years old, and that is your most productive, is the person that is 55, and until we recognize that we are not going to have that person around in the year 2020 or 2021 our agriculture is going to get sicker.

I feel like that agriculture——

Senator **Proxmire** [presiding]. Mr. Sims, I am going to have to interrupt just for a minute.

Mr. **Sims**. You may do so, yes, sir.

Senator PROXMIRE. Could you wind up in about a minute?

Mr. SIMS. I will be glad to.

I appreciate you all inviting us here, and I do hope you realize that the farm program is—if we are going to have a rural Texas or a rural America, we are going to have to have a stronger farm program. I would recommend that it not be a 4-year program, that it be a 15-year program.

Thank you for inviting us to come up here.

Senator PROXMIRE. Thank you very much, Mr. Sims.

Mr. SIMS. You are welcome.

[The prepared statement of Mr. Sims follows:]

PREPARED STATEMENT OF HON. BILL SIMS

Senator Lloyd Bentsen has compared the Texas rural economy to a big hunk of Swiss cheese. Recognizing that there are holes in the rural economy, he makes a good comparison, but my question might be, "Where is the cheese?" For the last four years all rural Texas has had are the holes!

Rural Texas started on a roller coaster ride in the late 1970s. The energy crisis fueled by inflation caused farm income to go up at a fast pace. This made much more money available to the rural people, and with the added bost from runaway energy prices, these folks never had it so good. Rural Texas depends on agriculture and the energy industries to maintain its financial base. Let me quickly explain why energy is so closely tied to the rural areas.

1. Probably one third of all agriculture producers participate in the energy business in one way or another. They either have production, they sell leases, they work on oil rigs, or they receive damages on well drilling or seismograph work.

2. Oil production produces jobs....roughnecks, pumpers, roustabouts, etc. During the 50s drought there were probably as many cowboys roughnecking as there were working on the ranches. Many a rancher paid his feed bill by working on an oil rig.

3. Land values increased because there was more money available to buy land and more competition.

4. Farmers cannot compete for labor with energy producers, so often our labor goes to the oil patch.

5. Recreation has become a major part of farm and ranch operations. The oil companies were quick to get big leases for hunting, deer, turkey and other animals, and almost any ranch that had hunting on it could be leased by people from the energy industries. As an example of how these wildlife leases aid not only the rancher but also the entire community, in Sutton County, Texas, which is in the Edwards Plateau with

only ranchland, a detailed study showed that a hunter will spend $65 a day while he is in Sutton County, not including the money paid to the rancher for the lease, so you can see this income is very, very important.

By 1980 we saw continued inflation. Commercial banks, the Federal Land Bank, Production Credit Association and thrifts were making loans to anyone who could sign their name on the dotted line. It should be noted that these loans were made on inflated collateral and not on cash flow. Farmers and ranchers were making big bucks, and many of the young farmers and ranchers just starting out were encouraged to go into debt....to buy land.....to buy big new equipment that was not needed....to buy anything to avoid paying federal income tax. With the very strong dollar worldwide and large banks making energy loans to anyone who acted like an oil man, real estate prices continued to go up and up. More and more oil-related dollars pumped into rural Texas, and the roller coaster continued going up and up.

1984 was the beginning of the end of the boom in rural Texas. In fact, the next three years were almost as devastating to rural Texas as the 1930s. What started the decline is not clear nor important at this point. The fact is, it ruined many people financially. Young farm families saw their dreams dry up and blow away. It was not a quick death. It started as a small festering sore and grew until it seemed they were consumed and broken.....with no way out but to go out of business.

Maybe it was the 20% interest used to squash the inflationary spiral and to weaken the dollar overseas, or maybe it was the move by OPEC lowering world oil prices. Maybe it was the decrease in market prices for agriculture products, or maybe it was two of the coldest winters on record back to back. Maybe it was the change in lending practices. Overnight it seemed that bankers found two new words.....cash flow. Money had been borrowed on inflated collateral that probably would not have stood the cash flow test at the time. Now they demanded cash flow to take the place of collateral.

The first to go were the young people. Whether it was a farmer in Concho County or a store owner in Lamesa or a small oil company in Midland or the banks that backed the energy boom.....it was everywhere.

The downfall of the banks and thrifts is history. I would note very few small rural banks bit the dust. It was the banks that were heavily involved in energy and real estate that went down.

Did anyone realize a roller coaster could go straight down? Yes, there were many people who knew roller coasters could pitch headlong down the hill. Many of the older farmers and bankers could still remember the Great Depression and the soup kitchens with the long lines of proud, broken people. The older farmers and ranchers paid their taxes and put money aside. The country bankers didn't quit the farmers and ranchers for the quick money from energy loans. By nature, country bankers are suspicious of quick and easy money. They are always looking around the corner for hard times. The older oil operators still remembered how fickle the oil and gas business could be. They had seen booms before, so they advanced cautiously.

Because of these older and wiser business people, the roller coaster has finally levelled out and is inching back up the big hill.

Things in rural Texas are looking up. Even though part of Texas is experiencing drought conditions, the livestock industry is strong and increasing. The farmers have experienced two good years with good cotton prices and other products experiencing strong markets. The businesses that are left in rural Texas are looking better. The real estate businesses have started to go up slightly. The oil industry has bottomed out and is starting to look for production. We see more and more in-field drilling. A few daring souls are even wildcatting, something which had completely stopped two years ago. Rig counts are edging upwards, and this is always a good sign of confidence.

While I remain very optimistic about rural Texas, I would like to point out a few problems that can develop because of the last four tragic years.

Rural education may end up being hurt as much or more than the farmers or the oil industry. The problem is that as real estate values increased and oil prices went up, all of a sudden, large amounts of tax monies were being pumped into the coffers of the rural schools. Because of this newfound wealth, the revenues of many small schools were much greater than they had ever dreamed. Bond issues were passed. When the skeptics asked where the money would come from to pay the bonds off, the president of the school board just assured the voters that with all the money they were getting, they could pay the bonds off in two or three years. These monies were used to replace the old 1930 school buildings or the 1940 auditorium or gym. The school districts were deep in debt. In gambling terms, they were betting on the come!

Then it happened. We started losing real estate and energy values. The tax money slowed to half of what it had been just the year before. Then energy-related families started leaving the small towns. Pretty soon towns were back to the people who were there before the boom started, but they now owed for a bunch of bonds and facilities that were planned for many more students than they now had. The problem now is going to be that the rural schools will have to raise their taxes more and more to be able to take care of their bonded indebtedness.

Rural health care is also experiencing major problems. As the tax values of rural lands have been eroding and people have relocated because of the sick economy, rural hospitals have been hard hit. Many of these hospitals were owned by the counties or had been taken over by the counties, so the tax base was forced to try to keep them open. It is estimated that fifty (50) rural hospitals closed in the last five years.

Some of the major problems have been low patient numbers due to people leaving rural Texas; malpractice insurance costs - many doctors cannot afford to deliver babies because of exorbitant insurance costs; specialization of physicians; shortage of nurses; average rural age of 65 years; indigent health care costs. In addition, Medicare and Medicaid payments to rural hospitals are on average 40% less than that paid to city hospitals. This is not right, and this and other problems must be addressed and corrected if our rural hospitals are to survive.

Another issue about rural Texas and rural America that I feel is very important and should receive your careful consideration is the absolute necessity of a much stronger farm program....not a four or five year program but one that is 10 or 15 years in duration so that we, the farmers and ranchers, can make plans for the future so that we can do a better job of farming and ranching. I would like to list several reasons why I consider the farm program necessary.

First of all, if the consumer of the United States is to continue and if we expect to retain a federal defense posture, it is necessary to have the cheapest food and fiber of any country among the manufacturing nations of the world. To expand on my statement relative to federal defense, if the U.S. wishes to maintain the capability to produce enough food and fiber to be self-sufficient in case of war, it goes without saying that it takes an awful lot of food and other products to feed and clothe an army and nation which is manufacturing the necessities of war.

The so-called farm program (consumer and/or defense program) is necessary to keep farmers producing, and it should be noted that our producers cannot compete with highly subsidezed foreign producers. Also, the cost of production in the United States is not controlled by the farmers but by the other industries that we must compete with for fuel, financing, labor, etc.

Another consideration is that the federal policy of free trade without consideration for fair trade has had a devastating effect on our farmers. I would like to use the example of the cotton industry. Cotton will probably bring 50¢ a pound this year on the world market. Production costs are estimated to be 50¢ a pound, but the program will add 20¢, thus allowing a profit so that the farmer can stay in business. The same concept works for all food and fiber crops. The nation lost a very large number of farmers and ranchers from ages 25 to 35 because of the disasters of the past few years. Because of this, in about 20 years we are going to be very short of farmers and ranchers who should be at their most productive stage. We lost them in the 80s and we can't get them back. We must be able to guarantee those young people who are left a profit so that we will have them to raise our food and fiber for us in the coming years. It should be noted here that to be a good farmer or rancher you should start early in life because you must learn so many of the tasks by doing them. There are no books or schools to prepare you for droughts, 20% interest or working day and night....and the list could go on and on. It's called the School of Hard Knocks. Also, we should remember if we want to keep our young people on the farm, we must make it interesting enough financially so they won't go off to the city to become a computer operator and miss the lessons they can only learn by doing. It is pretty hard to convince your son that his $600 a month salary is just as good as his best friend's $2,000 a month in the city or to convince him that he is having fun when the temperature is zero and he's breaking ice and freezing while feeding the livestock while his best buddy is sitting in a warm office.

In closing, I would like to reiterate that rural Texas is coming back. However, rural Texas depends heavily on energy and agriculture for its vitality. Please remember, we need a much stronger, longer lasting farm program if we plan to have a productive agriculture that will feed our nation in the 21st century.

Thank you very much.

Senator PROXMIRE. Mr. Leach, I understand you represent 47 districts from Linwood, KS, is that right?

Mr. LEACH. Yes, sir.

Senator PROXMIRE. And you serve on the Agricultural Food Policy and Rural Development Committee of the National Committee of State Legislators.

We are delighted to have you. Go right ahead, sir, and if you can confine your remarks to 10 minutes, we would very much appreciate it.

STATEMENT OF HON. ROBIN LEACH, KANSAS STATE REPRESENTATIVE

Mr. LEACH. Thank you, Senator Proxmire, and I appreciate the opportunity to come.

I guess it was my understanding today that one of the tasks of the Joint Economic Committee was to get our assessment of where we see rural America heading. So I can probably in very short order tell you some things that are of concern to me and I think the people of Kansas.

We have the same problem as Mr. Sims in the area of education, but I believe there are solvable solutions to the small urban schools, maybe not what everybody would accept, but we have a program of technology now that I think they call interactionary videos, or something like that, where we can put live teachers that communicate back and forth with children on a one-on-one basis, where we can have four or five of our districts and offer the same thing as the large urban centers for a lot less money.

I would propose that the Joint Economic Committee possibly look at a pilot project of some type of a joint funding, both Federal, State, and local, in those areas. I think it is a place that you could spend your dollars with great returns.

And I think Mr. Sims brought up the problem of rural health care. I am sure the committee is aware that there is a difference in funding of an operation in a rural hospital compared to an urban hospital. That could be changed, and I think basically it costs the same to amputate an arm in Topeka as it does in Oscaloosa. But those types of small things could keep our hospitals I think viable.

I have noticed something over the past few years that is alarming to me, and that is the problems of the elderly. It seems as you go door to door in each district you see more distinct differences between those that have and have not. I think one of your charts alluded to that earlier on, that you are seeing the elderly coming out of the large cities into the smaller centers to live because of the cheaper housing cost.

But that puts an undue burden on those rural areas, and I think that you could look at some kind of a program that would benefit both the Federal and State Governments as far as getting funding into the rural areas and find that it is cost beneficial to the Federal Government.

My district is not probably unlike a lot of the areas in Wisconsin, Senator Proxmire, that we spent a lot of time in hauling cows out. It seems we are hauling them all to California.

But anyway, we have a lot of small towns. These are small towns that—most of my towns are a thousand people, and yet we are next door to Kansas City and next door to Topeka. We have an infrastructure problem that is unbelievable. Every day you can expect some kind of a call from someone saying that their white clothes have turned yellow.

But we have those job areas outside in Kansas, in the eastern part, where people can work, but in the west that is not the case. We have done some things in Kansas, and really we haven't been very successful, if you want to know the truth, to try to rebuild our small town and rural areas.

I don't think we will be alone. I think it will be something that our local people would be glad to pay for, and I am sure our State government would help pay for, but I think you have to look at those charts and you have to realize that probably part of the thing starts with education and then the fact that the cost of living in the small, rural areas is so much less we get the urban people coming out to live in their later years.

But there are ways to do this, and I think that you are going to have to tailor a farm bill—and I have been somewhat active in the last few years on the farm bill—that tailors it to what I consider the part-time farmer, and, believe me, we have more part-time farmers in Kansas than we do full-time farmers anymore. Thanks to the last 5 years, I don't think we have hardly a full-time farmer that grew up on the land. It has all been in part-time farmers.

I would ask you to target that. I would also ask you to look at the Farmers Home Administration and to make them a faster moving organization where we can get some money in the rural development programs because it takes forever. The redtape is unbelievable, and they will drop it.

The young farmers today aren't applying for the FHA loans. They are flat not. They are penalized, for example, if they work in town. If they have more than 50 percent of their income or a certain percentage of their income from outside of agriculture, then they are not eligible for a loan, which is very counterproductive, sir, because those are the only ones that can pay it.

And with that, I think that I have tried to be somewhat brief and probably rambled a little, but if you decide that you need to use a carrot and stick approach, just kind of be sure that we can afford to take the carrot, and we can probably pick it from there.

And I thank you.

[The prepared statement of Mr. Leach follows:]

PREPARED STATEMENT OF HON. ROBIN LEACH

I AM STATE REPRESENTATIVE ROBIN LEACH OF LINWOOD, KANSAS. I WISH TO THANK SENATOR SARBANNES AND THE OTHER DISTINGUISHED MEMBERS OF THE JOINT COMMITTEE FOR THE OPPORTUNITY TO APPEAR TODAY TO DISCUSS ISSUES THAT I BELIEVE ARE OF UTMOST IMPORTANCE TO RURAL AMERICA.

IT IS MY UNDERSTANDING YOU ARE MOST INTERESTED IN OUR ASSESSMENT OF RURAL AMERICA AND WHERE IT STANDS IN TERMS OF ITS ECONOMIC HEALTH.

I AM SURE THAT KANSAS IS NOT UNLIKE THE REST OF AMERICA IN HAVING OUR SHARE OR PROBLEMS. I THOUGHT I WAS AWARE OF MOST OF THEM UNTIL RECENTLY WHEN IT WAS BROUGHT TO MY ATTENTION THAT SOME OF OUR SCHOOLS DO NOT ALWAYS RECITE THE PLEDGE OF ALLEGIANCE. TO GET RIGHT TO THE POINT, HOWEVER, MANY OF OUR SCHOOL SYSTEMS IN THE RURAL AREAS OF KANSAS SEEM INCREASINGLY HARD PRESSED TO PROVIDE THE BROAD EDUCATIONAL CURRICULUMS THAT ARE AVAILABLE TO SUBURBAN AND URBAN SCHOOL DISTRICTS.

I BELIEVE ONE AREA OF CONCERN THE JOINT COMMITTEE MIGHT WANT TO LOOK AT IS A PILOT PROJECT OF INTERACTIONAL VIDEOS, WHERE SMALL RURAL SCHOOL DISTRICTS COULD JOINTLY USE THE SERVICES OF EXPERT TEACHERS. THE VIDEOS COULD BE USED AS PILOT PROJECTS IN SEVERAL DISTRICTS AND PROVIDE COURSES THAT WE CANNOT PROVIDE ALONE. IT WOULD SEEM THAT A JOINT PROJECT WITH FUNDING BY FEDERAL, STATE AND LOCAL GOVERNMENTS FOR PILOT PROJECTS COULD BE VERY COST EFFECTIVE. (AND KANSAS WOULD LIKE TO PARTICIPATE.)

ANOTHER AREA OF GREAT CONCERN IN KANSAS IS THE ISSUE OF RURAL HEALTH CARE. I AM ESPECIALLY TROUBLED BY THE DECLINE IN THE QUALITY OF OUR RURAL HOSPITALS AND DOCTOR AVAILABILITY. KANSAS IS CURRENTLY EMBROILED IN A POLITICAL WAR

THAT IS BEING WAGED AT THE EXPENSE OF OUR KANSAS CITIZENS. I STRONGLY URGE THIS COMMITTEE TO LOOK AT THE WAY OUR RURAL HOSPITALS ARE FUNDED AS OPPOSED TO THE FUNDING OF HOSPITALS IN LARGE URBAN CENTERS. THE QUESTION IS BASICALLY DO RURAL AREAS GET SHORT-CHANGED IN TERMS OF EQUALITY AND QUALITY OF TREATMENT?

AS I GO DOOR TO DOOR IN THIS ELECTION YEAR, I FIND ANOTHER AREA TROUBLING ME IS THE DISPARITY BETWEEN THE HAVES AND HAVE NOTS. I CAN TELL YOU IT IS A LOT WORSE THAN TWO YEARS AGO, AND NOT ONLY AMONG THOSE ON FIXED INCOMES, BUT ALSO AMONG THOSE STILL IN THE WORK FORCE TRYING TO MAKE ENDS MEET. MY DISTRICT USED TO BE LARGELY DEPENDENT ON AGRICULTURE AND FULL TIME FARMERS. THAT IS NOT THE CASE NOW. THE LAND STILL REMAINS, BUT AGRICULTURE AS A FAMILY'S LIVELIHOOD IS THE EXCEPTION RATHER THAN THE RULE.

I URGE CONGRESS,TOO, IN DEVELOPING THE NEXT FARM BILL TO LOOK TO NEW AND INNOVATIVE WAYS TO DEAL WITH THE PROBLEMS AND NEEDS OF THE PART TIME FARMER. IF YOU DO NOT, TWENTY YEARS FROM NOW THE PART TIME FARMER MAY BE EXTINCT.

IN THE AREA OF OUR YOUNG PEOPLE WHO ARE NOT BLESSED BY AN INHERITANCE, STRONG MEASURES WILL BE NECESSARY TO ALLOW THEM TO ENTER AGRICULTURE. ONE PLACE TO START IS THE FARMERS HOME ADMINISTRATION. RIGHT NOW, IF A BORROWER'S INCOME IS ABOVE A CERTAIN PERCENTAGE FROM OUTSIDE OF AGRICULTURE, THEY ARE NOT ELIGIBLE FOR FMHA ASSISTANCE. THE IRONY OF THAT IS THAT IF THEY DON'T HAVE OUTSIDE INCOME THE LOAN BECOMES DEFAULT AND YOU HEAR ABOUT THAT HERE YEARS LATER.

I ASK YOU ALSO TO CONSIDER THE PROBLEM OF LACK OF JOBS IN RURAL AMERICA. SPECIFICALLY, WE NEED INDUSTRIES IN OUR SMALL TOWNS WHERE WE HAVE AN ABUNDANCE OF LABOR. PERHAPS THERE ARE SOME TAX INCENTIVES THAT COULD BE TARGETTED TO

THESE RURAL AREAS. AGAIN, I URGE YOU TO MAKE THESE AVAILABLE AS A JOINT PROGRAM WITH THE STATES. AND, IN ANY PROGRAMS WHERE YOU USE THE CARROT AND STICK APPROACH DO NOT MAKE THE GUIDELINES UNWORKABLE OR UNAFFORDABLE.

IN CLOSING, THE PLIGHT OF RURAL AMERICA IS NOT UNSOLVABLE NOR DOES IT TAKE MASSIVE AMOUNTS OF MONEY TO REBUILD AND CONTINUE US AS A STRONG LINK IN THE NATION'S ECONOMY. IT JUST TAKES EMPLOYING THOSE WITH IMAGINATION AND A DREAM WHO CAN MAKE RECOMMENDATIONS BASED ON THE KNOWLEDGE OF HOW FAR OUR PEOPLE IN RURAL AMERICA WOULD GO TO SEE OUR SMALL TOWNS GROW AND CONTUNUE THE PRIDE THAT SOMEHOW KEEPS THEM GOING WHEN OUR MAIN STREETS FOLD AND THE WHITE CLOTHES TURN YELLOW FROM OUR RUSTING WATER LINES.

MR. CHAIRMAN, AGAIN, THANK YOU AND I WOULD BE GLAD TO ANSWER ANY QUESTIONS.

Senator PROXMIRE. Well, thank you very much, Mr. Leach.

I would like to ask each of you, starting with Ms. McClure, this question.

The National Governors' Association, as I understand it, argues that a new Federal-State alliance is required if rural development efforts are to be successful. I would like to ask you, what do you see as the broad roles for the State and the Federal Government in that kind of an alliance, in terms of money, in terms of initiative, et cetera?

Ms. MCCLURE. Thank you, Senator Proxmire.

I agree in large measure, if not completely, with the Governors' Association and the movements that they have made to enlarge upon the State and Federal relationship, and when you ask about what initiative should be taken, that is something that we have wrestled with for a long time. I think that philosophically I would want the initiatives to be ones that would allow as much autonomy as possible to the States and for it to be a partnership kind of relationship, but one that would let the States implement the program.

I think in the past what we have seen very often is that the Federal Government through Congress will have an idea to make some change or improvement in American life and instead of giving the States the opportunity to efficiently administer a program, the Federal Government will hamper it with many strings attached and all kinds of conditions and qualifications.

We have learned over the years that we are willing and happy to participate in the program, provided that we can run it in our State, because we feel that we can do it more efficiently and that we can pinpoint the needs better in our State capital than can be done in Washington.

So we would like to continue partnerships, and particularly in rural economic development and delivery, but what we would like would be to be able to administer the programs and target the needs as we see them locally. We think that is beneficial.

Senator PROXMIRE. Well, one way to do that, of course, is for the Federal Government to contribute less money.

By and large, education, as you know—you are all experts in the State legislature—our States contribute most of the money and take the initiative and provide the fundamental policies for elementary and secondary education, also to a considerable extent for higher education, far more than the Federal Government does, and the States, of course, contribute far more to the cost of education.

Ms. MCCLURE. True. That is true.

Senator PROXMIRE. The Federal Government only puts in about 8 percent of the cost of elementary and secondary education.

And the reason why the Federal Government has been delegating to the States the autonomy that you call for and letting the States implement programs, and so forth, is because that is the State's money and the local government's money.

Ms. MCCLURE. Well, that is true in education.

Senator PROXMIRE. So to what extent could we have that kind of pattern applied to agricultural development, rural development?

Ms. MCCLURE. Well, Senator Proxmire, one of the congressional mandates is Public Law 94-142 in education, calling for special education for special children, handicapped and gifted, and originally when the act was passed the funding was to be at a 40-percent level on the part of the Federal Government. Instead, I believe it is at about 5 percent. One of our fastest growing costs is in special education, and we have had to fund that largely by the State. The school districts can pick up some of it but largely it is the State funding program.

Now, here I feel that the Federal Government has not lived up to its obligation. We have implemented the program, but we have not received the dollars. I don't know if that answers your question, but I certainly think that if the Federal Government would fully fund, or at least 40 percent fund, as was originally intended in Public Law 94-142, that would be a great help because that is our fastest rising educational cost right now.

Senator PROXMIRE. Mr. Martin, as you know, we have a fiscal problem that just won't stop. It is going to dominate, unfortunately, the policies of the next President of the United States and the next Congress.

We have an enormous deficit and a huge national debt, and the States are in relatively good shape.

What is your answer to this question?

Mr. MARTIN. First of all, I have my own answer to solve the national debt problem, but I guess that is not why we are here this morning.

Senator PROXMIRE. If you can give that to us in about 10 seconds and go on to the rural development, that will be fine. [Laughter.]

Mr. MARTIN. Well, you may have to raise taxes. You can't continue to pass out money without someone paying the bill.

But specifically on the issue that you raised as to what you can do to help us, I think it is obvious that we are not going to get additional tax revenues from the Federal Government at this point, but it seems to me that what you need to do is help us with tax policy.

For example, one of the things I raised in my testimony was the issue of the small industrial bonds, and that particular one is going off—being taxable at that point sometime next year. It seems to be that the only way you are going to help rural America is by having a low interest rate.

When you can borrow money at the prime rate of 3 percent in Japan and we are paying 14 and 16, 18 percent here in the United States in rural areas to have and to start a small business, then I think what you are doing is that you are really putting us at a disadvantage because we are talking about a national economy—an international economy rather than a national economy these days. The competition is no longer within the Nation. It is between nations.

Senator PROXMIRE. You couldn't be more right. The fact is that we have an international economy and few of us really realize it.

Mr. MARTIN. Yes.

Senator PROXMIRE. There has been a fantastic increase in the flow of funds across borders. In fact, it has increased literally thirtyfold in the last 11 years.

I spoke on that on the floor of the Senate just yesterday. It is something that very few people appreciate, and it is something that makes interest rates very hard for us to control except to the extent that we can cut our Federal spending and, as you say, increase taxes and get the deficit under control.

Mr. **Martin**. That is right. I mean, you can also take advantage of a lower interest rate by having a tax policy which benefits and allows States to have lower interest rates and not being taxed, which is of some help to us.

We have that in a couple of programs now in Maine, and we can actually provide agricultural programs in rural areas for 8 and 10 percent, which is doing an unbelievable amount of help, and it is the type of thing that we can continue.

We have a program which is also part of my testimony known as FAME, the Finance Authority of Maine, which provides those kinds of loans and actually goes out and helps the farmer.

Senator **Proxmire**. In your judgment, is that practical to apply to other States that are more heavily agricultural?

Mr. **Martin**. Absolutely, and I think that kind of program would work a heck of a lot better done State by State than trying to have the Federal Government do it.

I think that it is obvious that some of the loan programs of Farmers Home Administration, they are geared for certain industries, certain types of areas of this country but not in others. So I think that a regional policy and a sectoral policy is far better than a national policy in terms of trying to deal with that whole issue.

Senator **Proxmire**. Mr. Sims.

Mr. **Sims**. As I have said, whatever the Governors think about it with the Federal Government, a lot of programs don't seem to work too well, but if you want to help rural Texas you will do something about rural health because people are not going to live in a small town if there is not a doctor there.

So you are going to have——

Senator **Proxmire**. You say they will not live in a small town if what?

Mr. **Sims**. If there is not a doctor there. And they are just not going to do it because they can go to retirement centers or do other things.

The second thing is if you don't have a strong agriculture you are not going to have a town there, and we have seen there and you have seen it in your State, where the little towns are no longer there, and until we accept this and go to a stronger, I think, farm program.

Then the third thing, of course, I, as an agriculture producer, have so much Federal redtape and so much intervention from the Federal Government that I barely can know what to do, you know, every day, whether you are supposed to do this and not do that. We have had too much control on the rural health problem. I am sure you are aware of it. The representatives talk about it—is that Medicaid payments in rural hospitals is 40 percent less than it is in urban hospitals, and why in the world that is I have no idea.

Thank you very much.

Senator **Proxmire**. Thank you sir.

Mr. Leach.

Mr. **Leach**. Thank you, Senator. I am not against taking Federal dollars, but I understand you have a problem. I think there are a lot of ways you can change it. I think one of them is to put some people that run their bureaucracies that are a little more receptive to the States' needs and have some authority to move. I think that is a great deal of it.

I think that if I were the Federal Government, with the deficit you have, I would worry very strongly that I put some money out from the Federal level. States have a tendency to hang onto their money, and they hang onto it pretty tight, especially in Kansas.

But I think we can match moneys, and I think we can take small amounts of Federal moneys and make things out of them, but it is going to take some joint type of doing and some kind of less control on the Federal bureaucrat who might be running the program, Senator.

Senator **Proxmire**. Thank you. You think that we should rely more than we do now on matching, that that would be——

Mr. **Leach**. To me it is the way——

Senator **Proxmire**. That is an interesting innovation. We don't do much of that in agricultural policymaking.

Mr. **Leach**. Yes, but I think it is a possibility, and I think you could also open up the Tax Act again. You might want to be able to look at some incentives in the job area because we can't—we pass all these great laws in Kansas to get jobs in the rural towns, and it doesn't work because these people pay no State taxes. They pay Federal taxes.

So that is something I would ask you to consider, Senator, and there is a lot of other ways we can talk about but I am sure that you have probably heard them all.

But we do have money in Kansas. It is your money from the Federal windfall, but we call it ours now. But we can do some things.

Senator **Proxmire**. Thank you, folks, very, very much. You have been an excellent panel and we certainly have experts from the States here.

Our next panel is Mr. Murray Lull, representing the American Bankers Association; John Spies, president of the Iowa Trust & Savings Bank of Emmitsburg, IA, representing the Independent Bankers Association; Jack Cassidy, National Bank for Cooperatives; and Richard Larochelle, National Rural Electric Cooperative Association.

Well, gentlemen, we are delighted to see you. I am especially delighted. As you may or may not know, my other hat is chairman of the Senate Banking Committee. So I feel right at home, and I hope you do.

Mr. Lull, go right ahead. I hope you can confine your remarks, if possible, to 10 minutes. As you know, we have another panel and the hour is getting late.

Go right ahead.

STATEMENT OF MURRAY D. LULL ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. **Lull**. Thank you, Mr. Chairman. Good morning. My name is Murray Lull. I come from a rural community of 2,500 people in north-central Kansas, and I am the fourth generation president of my small bank there. I am also vice chairman of the Agricultural Bankers Division of the American Bankers Association.

My concerns and those of the American Bankers Association bring me to your committee to convey to you the sense of need, urgency, frustration, and, of course, the hope that a sensible and timely effort might be made to develop and sustain rural America.

In spite of the efforts that I have seen my community make to keep it viable, Smith Center, KS, is facing the same formidable erosion of our culture that I am sure countless thousands of other small communities and counties are encountering.

In spite of the efforts of the community development groups, city councils, county commissioners, private venture capital formations, the efforts of the Small Business Administration and Farmers Home Administration, and certainly the efforts of small banks such as mine, there is still a strong sense that we are losing the battle of our rural communities' lives.

The American Bankers Association appreciates this opportunity to participate in this hearing on the serious problems facing rural communities in this country. Our association's members represent 95 percent of the industry's total assets and about 85 percent of our membership is represented by community banks of $100 million or less in assets.

While the ABA represents the very small banks, such as mine, and the very large banks, we all certainly have a stake in what is happening in America's rural areas.

We commend this committee for holding this hearing to explore the difficulties facing rural America. The points we would like to make are these:

No. 1, the American Bankers Association and our banks want to be involved and to make available whatever resources we have in this effort.

No. 2, banks are now and have been major players in rural development and sustenance efforts, but we and those we work with need more help in fighting the erosion of our rural population, our economic activity, and our infrastructure.

No. 3, in any economic activity capital makes many things possible. Provision of capital is one of the key banking functions in our economy. When it comes to capital infusions in America's rural development efforts, because of the restraints on banking that very correctly center on the safety and soundness of our banks, we are providing most of the capital we are currently allowed to provide.

It is very important in rural communities that the people of our communities have trust in their depository institutions, and people do trust their banks to keep their money safe. We just cannot make grants of our depositors' money in the name of rural development. We want to stress that point.

Bankers are sometimes accused of lacking concern for those who wish to borrow but who, by the measurements we must make, of course, lack the capacity to meet banking regulatory standards. Very simply, our banking regulatory system is designed to protect our depositors' funds. Any credit we extend must be adequately collateralized and based on adequate cash-flows to reflect an ability to repay.

While it has been painfully clear over the last decade that lack of attention to these principles can produce disastrous consequences, we still try to take some chances on promising business people who lack collateral.

For instance, in my community two young ladies, a divorcee and her sister, wanted to start in Smith Center, a Kansas equivalent of a McDonald's Restaurant. They had no collateral, no money, and no experience, and yet we knew they knew how to work hard. We took a chance in this one case, loaned them the money. They developed the business. They came back for loans to expand, and we did loan them more, based not on collateral, not on cash-flow, but on the fact that they had the desire to work, and because of their hard work we now have a small business in our community that is providing employment for a number of young people.

The point here is, No. 1, that in this true situation our loan to these young sisters would be criticized by our regulatory authorities because of the lack of collateral and cash-flow. It is the type of loan that was made in the old days based on character, but today, of course, the times have changed.

We must look carefully at what the real problems are in rural areas as we seek to develop solutions. Sustaining existing rural Main Street businesses and starting new ones and retaining our infrastructure all require capital. While our banking system is one of the logical delivery systems of this capital, solutions to our rural needs must also address the need to protect the safety and soundness of our deposits.

Federal credit guarantees have in the past provided this deposit protection, but they can be expanded and enhanced. Thought must be given to the parameters and criteria in guaranteed loan proposals. Oftentimes loans submitted for guarantees now to the Small Business Administration or to the Farmers Home Administration actually require standards for approval greater than those of some of the loans that we are making without guarantees.

Ironically, those agencies that are established to protect the depositors' money from risk are very concerned now about the risk they themselves make through these guarantees. These guarantees ought to allow more thinly capitalized loan proposals to be favorably considered because these proposals are the ones we get to see in Smith County, KS. These are typically the proposals that could mean another business that could bolster our economy.

One thing I would like to make clear to you is that I don't think that there is a lack of credit in our rural areas. I think there is, however, at times a lack of creditworthiness. I don't believe there is a lack of desire to provide capital to our rural businesses, but there are at times lacks of a way to do it and at the same time protect the people who make these funds available in the first place, the depositor.

We are here today to tell you that America's banks are serious about keeping our rural communities alive and well. The only problem is that you and we have to sit down and decide what is needed and what the tradeoffs are and how to keep our depositors protected.

Mr. Chairman, the events of the 1980's have clearly demonstrated that the health of community banks is tightly linked to the viability of our local economies, and vice versa. The banking industry therefore has an important stake in strengthening and diversifying the economic bases of the small towns and rural areas across America.

Our banks offer experience, knowledge of local markets, financial expertise, and a serious commitment to the revitalization efforts being made by your committee. We look forward to working with you and your colleagues on these issues.

Thank you.

[The prepared statement of Mr. Lull follows:]

PREPARED STATEMENT OF MURRAY D. LULL

Mr. Chairman and Members of the Committee, I am pleased to be here to participate in this forum on behalf of the American Bankers Association. I am Murray Lull, President, Smith County State Bank and Trust Company in Smith Center, Kansas, and I am currently the Vice Chairman of the Executive Committee of the Agricultural Bankers Division of the ABA.

Our Association's members represent about 95 percent of the industry's total assets. Approximately 85 percent of our members are community banks with assets of less than $100 million. But one of the advantages that the American Bankers Association has in this discussion of rural development is that we have access to the resources of small community and agricultural banks, regional banks and money center banks, all of which have an interest in restoring economic vitality to the rural communities of this country.

We are concerned about the current situation. For example, I am from a rural community of 2,500 in north central Kansas. Despite the serious efforts that I have seen my community make and in which my bank has participated, I see a continued erosion of population and economic activity. I am not alone. Many other bankers in other communities share my concern. For that reason, the American Bankers Association has made rural development one of our focal issues for 1989. I am pleased to assure you that the Agricultural Bankers Division will have a major role in this effort.

I do want to note that the ABA recognizes that the problems facing rural communities are inter-connected. Education, health care facilities, water systems, sewer systems and other factors are very much a part of any rural development equation. Credit is only one aspect of the total picture. My comments are primarily directed at the appropriate role for banks, but we plan to be involved in discussions with representatives of these other key areas. We must all work together in our communities, and we should work together here at the federal level as well.

Mr. Chairman, rural communities (especially those heavily dependent on agriculture and natural resources) are going through a period of wrenching change. As employment opportunities disappear, skilled workers and the young are migrating from rural to urban and suburban areas in search of jobs. Local governments in agricultural areas are faced with reduced tax bases and deteriorating infrastructures.

The magnitude and intransigence of these problems have all been well documented. Solving them will require the best efforts of both the public and private sectors. We commend this committee for holding this hearing to explore the difficulties facing rural America and to contribute to the development of policy initiatives to begin revitalizing our rural communities.

Experts in agricultural economics believe that the farm sector is stabilizing. However, the severity of the cyclical downswing of U.S. agriculture which began in 1981 taught us a valuable lesson about the need for economic diversification in our rural communities. Without diversification, we will remain extremely vulnerable to future fluctuations in the farm economy.

Economic diversification will not be easy to achieve. Policies which encourage public and private investment in rural America are a vital ingredient in rebuilding the economic base of farm communities. As the basic comprehensive financial intermediaries in rural areas, banks must play a central role in this investment process by providing credit to assist new businesses, to encourage diversification in agricultural production, and to fund improvements in education and community infrastructure.

Local banks have a major stake in the economic health of their customers, and they are uniquely qualified to meet the credit needs of their communities. But banks must also operate within the parameters of safety and soundness laid out by bank regulators. I want to stress this point. Bankers are sometimes accused of lacking concern for those who wish to borrow but lack collateral and/or adequate cash flow. The banking regulatory system of this country is designed to protect banks' depositors. To do that, the regulators examine our loans very carefully to be certain that they are adequately secured with an appropriate cash flow. If the regulators determine that a bank's loans are not of sufficient quality to protect the safety and soundness of the institution, they classify them as substandard. A number of classified loans can lead to very negative consequences for the bank's management and directors. The bank may not survive.

My point here is that we must look carefully at what the real problems are in rural areas as we seek to craft solutions. If we want to start brand new businesses, we need a better mechanism for getting venture capital to rural areas - not necessarily loans. If we want to lend money to borrowers without collateral or experience as a public policy, then we should look at the appropriate mechanisms to do that while continuing to protect the safety and soundness of our financial institutions. For example, we should examine the existing programs of the Small Business Administration and the Farmers Home Administration and consider the options for modifying and expanding them.

However, we should not simply assume that our existing institutions do not want or are not able to achieve the public policy goal of providing capital or loans to businesses in rural areas. There are impediments to some of this involvement that have been created for very good reasons, bank regulation being a major one. We must identify carefully the goal that we seek and then look for an appropriate means to achieve it. As we do this, we should not ignore the already existing goal of protecting the safety and soundness of our financial institutions.

Federal loan guarantees offer one way to allow banks to provide the credit necessary to build a diversified economic base in rural areas while at the same time protecting the financial integrity of the banks. Our Association has consistently opposed the use of direct federal loans believing instead that guaranteed loans made through local lending institutions are a more appropriate way to provide credit to residents and businesses in communities.

Loan guarantees can be designed to suit various types of business needs. For example, a guaranteed line of credit offers a flexible way for businesses to handle cash flow problems and to assure businesses that their operating capital needs can be met by a local bank. A federal guarantee would allow a bank to extend such a line of credit even to new business ventures which might otherwise not have the necessary collateral to secure the loan to the satisfaction of bank regulators. The Farmers Home Administration Business and Industry guaranteed loan program for businesses affected by the drought authorized by the recent Disaster Assistance Act is another commendable use of the program.

A loan guarantee program could also be structured to encourage farmers who are producing crops supported by government programs to put at least part of their land into the production of nontraditional crops. Because experimenting with alternative crops increases the risk of the farming operation, it is more difficult and more expensive to obtain financing for such ventures. As a consequence, most farmers choose to continue to produce crops supported by government farm programs. A multi-year loan guarantee would encourage crop diversification by reducing risk to the lender, and therefore the cost of credit to the borrower. A multi-year commitment would ensure the farmer's continuing access to production funds during the transition period. A switch to alternative, nontraditional crops will not only promote crop diversification but would also help reduce dependence on federal price support programs.

As agribusinesses begin the process of rebuilding and expanding, they will need not only access to capital but sound financial advice as well. A financial plan is critical to the success of all business ventures, but may be beyond the reach of some farmers and small business people. One way to help local agribusinesses gain access to professional financial counseling is to offer a matching grant program that would allow each state's extension service to contract with local financial institutions. The extension service could then act as a conduit through which farmers and agribusinessmen could tap the financial expertise of local lenders in drafting their financial plans.

Many experts have stressed the need for improvements in rural communities' infrastructures to attract new businesses and to retain existing businesses. In particular, roads, water and sewer systems, utilities, and health care facilities are essential ingredients to support long range economic growth. Obtaining the necessary funds for such projects is made more difficult for small towns because banks cannot underwrite revenue bonds.

Mr. Chairman, I am pleased to note that legislation authorizing banks to underwrite revenue bonds passed the Senate by a 94 to 2 vote on March 30. This authority, contained in S. 1886, would significantly help commercial banks make a positive contribution to rural development by underwriting local issues of revenue bonds.

There is clear evidence that increased competition in revenue bond underwriting would reduce the cost of funding community improvements. Municipal government experts estimate that bank participation could save revenue bond issuers as much as $5 per $1,000 of borrowed funds. Since small bond issues do not attract regional or national attention, and since investment banks do not have a local presence and customer contact in small communities, banks are the natural underwriters for small municipalities.

For some communities, federally guaranteed loans may be necessary to help fund infrastructure improvements. Such loan guarantees targeted towards public works programs may enable a local government to provide essential community services that it otherwise could not afford.

Mr. Chairman, the events of the 1980s have clearly demonstrated that the health of a community bank is inexorably linked to the vitality of its local economy. The banking industry therefore has an important stake in strengthening and diversifying the economic base of the small towns and rural areas across America. Community banks offer knowledge of local markets, financial expertise, and a serious commitment to the revitalization efforts being made by your committee. We look forward to working with you and your colleagues on these very important issues.

Senator PROXMIRE. Thank you very much, Mr. Lull, for a fine statement.

The next witness is John Spies. Is that correct, sir?

Mr. SPIES. Yes, sir.

Senator PROXMIRE. President of Iowa Trust & Savings Bank of Emmetsburg, IA, and representing the Independent Bankers Association of America.

Mr. Spies, go right ahead.

STATEMENT OF JOHN F. SPIES, PRESIDENT, IOWA TRUST & SAVINGS BANK, EMMETSBURG, IA, AND MEMBER, AGRICULTURE-RURAL COMMITTEE, INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Mr. SPIES. Senator Proxmire, I am John F. Spies, president of the Iowa Trust & Savings Bank in Emmetsburg, IA. I also serve on the Agriculture-Rural Committee of the Independent Bankers Association and am testifying in that capacity today.

The IBAA membership includes about 4,270 rural banks that are located outside of metropolitan areas. About two-thirds of those banks have at least 15 percent of their total loans in agriculture loans. The banks are generally locally owned and managed and are committed to the communities in which they are located.

We learned—or relearned—from the severe recession experienced by many of our rural areas during the 1980's that business diversification is essential to maintain the vitality of rural communities. Agriculture is at the center of many rural economies, but we must have nonagricultural industry to provide greater stability to rural communities. Without the stability that diversified business and industry can bring, the drain on our schools, health care systems, and other aspects of rural life is just too great.

Credit availability is critical for rural economic growth. However, credit and other forms of financing must occur in combination with other essentials, including entrepreneurs who are motivated to establish and manage businesses in rural areas, technical resources necessary for successful loan operations, and community leaders who are committed to growth and the expansion of job opportunities.

Independent community banks are positioned to contribute to all of these ingredients of rural economic growth. Several thousand, as I said, are locally owned and locally controlled within their communities. Working within the proper limits of financail safety and soundness, those banks are just as committed to the betterment of their rural communities as any other public, private, or cooperative institution might be. The community banks literally live and sometimes die with the local communities that they serve.

The independent banks provide several types of credit in rural areas. They finance small business startups and expansion. They can assist in the financing of road construction, water and sewer systems, and other forms of infrastructure. And, of course, they provide much of the credit for agriculture.

Loanable funds are generally available in community banks, mostly from local deposit sources. As of June 30, 1988, the loan-to-deposit ratio of U.S. banks under $100 million of assets was 58.2

percent. Rural banks, in particular, generally have existing capacity to make more loans to qualified borrowers.

Commercial banking institutions must operate within limits of safety and soundness. A great deal of the credit that banks, as financial intermediaries, can extend usefully to rural business needs outside enhancement to reduce its riskiness. In light of the budget deficit problems, direct government financing of rural enterprise obviously must be very restrained. Particularly under those circumstances, government can work through and leverage community banks and other private sector lenders in promoting rural business growth.

Government loan guarantees, when properly managed, have proven to be quite effective in the leveraging of private capital for rural business development. For several years the Farmers Home Administration in USDA operated the Rural Business and Industry Loan Guarantee Program with the result of providing substantial new capital for rural business. We believe that program could be usefully revived.

On a broader scale, the Small Business Administration Loan Guarantee Program continues to provide credit enhancement for banks to finance small businesses. Job growth is particularly associated with small business, and SBA loan guarantees channeled through local community banks tend to assure that rural small businesses get a major share of the financing.

As a supplement to the loan guarantee program, we believe that a properly structured secondary market for small business mortgages could provide a major source of finance for business in the rural areas.

The "Farmer Mac" secondary market established by Congress last year as a part of the Agricultural Credit Act of 1987 created a precedent of sorts for a broader secondary market for small business and for rural development financing. Farmer Mac itself will provide a market for rural housing mortgages, in addition to the farm mortgages, which should substantially improve the availability and terms of financing of rural residences once Farmer Mac is operating in the rural housing field.

A separate secondary market for small business finance could be useful for at least two reasons. First, it would enable local banks to provide longer term, 25- to 30-year real estate type mortgages for small businesses that may be inadequately available today. In fact any secondary market established for small business finance should probably be limited to longer term mortgage type financing.

Second, for budgeting purposes, a secondary market could remove government involvement by one additional step compared with the loan guarantee programs.

I believe that rural businesses would receive a major share of the financing from a secondary market for small business, provided that the market was structured so that small business mortgages could be originated on a broad basis by local community banks.

In general, we believe that the existing financial intermediaries can provide the credit financing needed for the growth and vitality of rural communities. Rural areas need balanced inputs for economic growth, including timely financing alongside technical expertise and other components.

With the enhancements that loan guarantees, a potential secondary market for small businesses, and other such mechanisms can provide, local banks can work with others in rural areas to assure that business and community growth is encouraged and supported.

This concludes my prepared statement, Senator, and I would be pleased to respond to any questions.

[The prepared statement of Mr. Spies follows:]

PREPARED STATEMENT OF JOHN F. SPIES

Mr. Chairman, Members of the Committee, I am John F. Spies, president of the Iowa Trust and Savings Bank in Emmetsburg, Iowa. I also serve on the Agriculture-Rural Committee of the Independent Bankers Association of America and am testifying in that capacity today.

The IBAA membership includes about 4,270 rural banks that are located outside of metropolitan areas. About two-thirds of those banks have at least 15 percent of their loans in agricultural loans. These banks are generally locally-owned and managed and are committed to the communities in which they are located.

We learned--or relearned--from the severe recession experienced by many of our rural areas during the 1980s that business diversification is essential to maintain the vitality of rural communities. Agriculture is at the center of many rural economies, but we must have non-agricultural industry to provide greater stability to rural communities. Without the stability that diversified business and industry can bring, the drain on our schools, health care systems and other aspects of rural life is just too great.

Credit availability is critical for rural economic growth. However, credit and other forms of financing must occur in combination with other essentials, including entrepreneurs who are motivated to establish and manage businesses in rural areas, technical resources necessary for successful business operation, and community leaders who are committed to growth and the expansion of job opportunities.

Independent community banks are positioned to contribute to all of those ingredients of rural economic growth. Several thousand community banks are locally-owned and locally-controlled within their communities. Working within the proper limits of financial safety and soundness, those banks are just as committed to the betterment of their rural communities as any other public, private, or cooperative institution might be. The community banks literally live, and sometimes die, with the local communities that they serve.

The independent banks provide several types of credit in rural areas. They finance small business start-ups and expansion. They can assist in the financing of road construction, water and sewer systems, and other forms of infrastructure. And of course they provide much of the credit for agriculture.

Loanable funds are generally available in community banks, mostly from local deposit sources. As of June 30, 1988, the loan-to-deposit ratio of U.S. banks under $100 million of assets was 58.2%. Rural banks, in particular, generally have existing capacity to make more loans to qualified borrowers.

Commercial banking institutions must operate within limits of safety and soundness. A great deal of the credit that banks, as financial intermediaries, can extend usefully to rural business needs outside enhancement to reduce its riskiness. In light of the budget deficit problems, direct government financing of rural enterprise must be very restrained. Particularly under those circumstances, government can work through, and leverage, community banks and other private sector lenders in promoting rural business growth.

Government loan guarantees, when managed properly, have proven to be quite effective in the leveraging of private capital for rural business development. For several years, the Farmers Home Administration in USDA operated the Rural Business and Industry Loan Guarantee Program with the result of providing substantial new capital for rural business. We believe that program could be usefully revived.

On a broader scale, the Small Business Administration loan guarantee program continues to provide credit enhancement for banks to finance small businesses. Job growth is particularly associated with small business, and SBA loan guarantees channelled through local community banks tend to assure that rural small businesses get a major share of this financing.

As a supplement to the loan guarantee programs, we believe that a properly-structured secondary market for small business mortgages could provide a major additional source of finance for business in rural areas. The "Farmer Mac" secondary market established by Congress last year, as a part of the Agricultural Credit Act of 1987, created a precedent of sorts for a broader secondary market for small business and rural development financing. Farmer Mac itself will provide a market for rural housing mortgages (in addition to farm mortgages), which should substantially improve the availability and terms of financing of rural residences once Farmer Mac is operating in the rural housing field.

A separate secondary market for small business finance could be useful for at least two reasons. First, it could enable local banks to provide longer-term 25-30 year real estate-type mortgages for small business that may be inadequately available today. In fact, any secondary market established for small business finance should probably be limited to longer-term, mortgage-type financing. Second, for budgeting purposes, a secondary market could remove government involvement by one additional step, compared with the loan guarantee programs.

I believe that rural businesses would receive a major share of the financing from a secondary market for small business, provided that the market was structured so that small business mortgages would be originated on a broad basis by local community banks.

As indicated earlier, community banks can assist in the financing of various local government infrastructure projects in rural areas. One means for this to occur is for a local bank to buy tax-exempt bonds issued by a unit of local government. A provision of the Tax Reform Act of 1986 is designed to encourage this type of financing, by providing that financial institutions which acquire small-issue bonds from local governments may deduct as an expense 80 percent of the carrying costs attributed to those bonds. A local government may issue up to $10 million of such bonds annually. To the extent that the bonds are bought and held by local community banks, rural communities should receive a major share of the financing.

In general, we believe that existing financial intermediaries can provide the credit financing needed for the growth and vitality of rural communities. Rural areas need balanced inputs for economic growth including timely financing alongside technical expertise and other components. With the enhancements that loan guarantees, a potential secondary market for small business, and other such mechanisms can provide, local banks can work with others in rural areas to assure that business and community growth is encouraged and supported.

This concludes my prepared statement, Mr. Chairman, and I would be pleased to respond to any questions.

Senator **Proxmire**. Thank you very, very much.

Gentlemen, I want to thank you, and I apologize—I am embarrassed—I have a commitment that I can't possibly change, but I am going to suggest that the committee stand in recess for a very few minutes. Chairman Sarbanes is on his way. He will be here within a very few minutes.

So the commitee will stand in recess for a couple of minutes.

Thank you again. These were very fine statements.

[A short recess was taken.]

Senator **Bingaman** [presiding]. Why don't we go ahead and complete the testimony here?

I gather that in the second panel Mr. Lull and Mr. Spies have already testified. Mr. Cassidy and Mr. Larochelle have not.

Is that correct?

Mr. **Cassidy**. That is correct, sir.

Senator **Bingaman**. Mr. Cassidy, why don't you go ahead with your testimony.

STATEMENT OF JACK E. CASSIDY, VICE PRESIDENT, CORPORATE RELATIONS, NATIONAL BANK FOR COOPERATIVES

Mr. **Cassidy**. Thank you, Mr. Chairman. I appreciate the opportunity to testify today on behalf of the National Bank for Cooperatives.

My name is Jack Cassidy. I am the vice president for corporate relations with the National Bank.

I will summarize my prepared statement and request that my entire prepared statement appear in the record.

Senator **Bingaman**. That will be fine.

Mr. **Cassidy**. Thank you, sir.

The National Bank is a new multimillion-dollar bank formed on June 30 as a result of a nine-bank merger within the Farm Credit System. The Farm Credit system is a nationwide network of farmer-owned banks and associations.

When it begins operations on January 1, 1989, the National Bank for Cooperatives will offer a complete line of financing and related services to agricultural cooperatives, rural utility systems and other eligible borrowers. The bank will also finance agricultural exports and provide international banking services in support of U.S. farmer-owned cooperatives' international activities.

The nine Banks for Cooperatives that are merging to form the National Bank have a combined total of $8.2 billion in loans outstanding as of June 30, 1988. Based on that loan volume statistic, the National Bank will be the 15th largest U.S. provider of commercial credit to businesses.

Agricultural cooperatives and rural utility systems and the credit programs they rely on have a significant effect on the rural economy. For example, the 70 largest borrowers of the Banks for Cooperatives have total annual sales in excess of $33 billion and assets of $28 billion.

The Fortune 500 list of industrial enterprises includes 15 agricultural cooperatives, 14 of which have a banking relationship with the Banks for Cooperatives. These 15 agricultural cooperatives employ about 60,000 people, nearly all in rural areas. These statistics illustrate the important economic contribution being made by the borrowers of the Banks for Cooperatives. These numbers are also indicative of the role the Banks for Cooperatives could play in contributing to the revitalization of rual America.

My testimony includes information about the credit programs offered through the banks; however, I will focus on two areas in particular this morning, community development financing and export financing.

With regard to community development financing, the Department of Agriculture estimates America's 46,000 rural communities will require over $20 billion in capital expenditures to bring rural waste water treatment facilities up to national standards. In the past, the Farmers Home Administration and other Federal agencies have provided billions of dollars in grants and low-interest loans to build or improve water and waste water treatment facilities. However, current budgetary restrictions make it unlikely adequate amounts of Federal assistance will be available in the future.

The Banks for Cooperatives have been able to meet some of the needs of rural communities by financing the prepayment of Farmers Home Administration community development loans. Many rural water associations, for example, serve a high percentage of farmers and are owned by their users. Such associations are eligible for loans from the Banks for Cooperatives.

Most small communities are not capable of obtaining a bond rating or acquiring long-term funds from traditional commercial lenders. The Banks for Cooperatives, with over 15 years of experience in financing rural utility systems, are in an excellent position to help address these credit problems for eligible borrowers.

With respect to export financing, the Banks for Cooperatives are the only U.S. lenders that make significant and consistent use of the Department of Agriculture's export loan guarantee programs. Most of the other lenders using the programs are foreign banks. It is ironic that American farmers must depend on foreign banks to finance the export of agricultural products.

Last spring, the Wall Street Journal reported that American exports were being hampered due to a lack of financing. An American banker was quoted as saying "one of the reasons the agricultural community can't export to (developing countries) is they can't get financing."

Last fall, the Washington Post reported on a speech made by the Chairman of the U.S. Export-Import Bank. The news article was entitled "U.S. Banks Accused of Failing To Meet Needs of Exporters."

I would ask that both of those articles be reprinted in the record.

Senator **Bingaman**. We will include those in the record at the end of your prepared statement.

Mr. **Cassidy**. Thank you, sir.

While the other money center commercial lenders have curtailed or eliminated their agricultural export financing operations to pursue more profitable endeavors, the Banks for Cooperatives recently reached a new record of $1.7 billion in export loans. Despite the rapid growth in this lending program, not a penny of principal has been lost.

Adequate financing must be a key part of any plan to increase agricultural exports. Adequate financing improves the marketability of agricultural products and the health of rural economies. Clearly, the Banks for Cooperatives could make a greater contribution to promoting agricultural exports if the authority were available.

Mr. Chairman, there is a growing interest on the part of the Federal Government and the farmer-owners of the Farm Credit System in promoting cost efficient and job creating economic development in rural areas. This interest has caused the Banks for Cooperatives to begin a study of innovative ways in which the banks can contribute to economic growth in rural areas.

One of the credit issues we believe needs to be addressed is the inability of most rural communities and cooperatives to access the types of commercial banking and investment banking services available to large corporations. The availability of these services would help rural communities and cooperatives to obtain needed long-term capital from national and international credit markets and make products produced in rural areas more marketable.

One idea under study would enable the Banks for Cooperatives to establish finance subsidiaries to provide new financial services to communities and rural cooperatives. One option would be to obtain their loan funds from private credit markets instead of the Federal agency market that is the traditional source of funds for the Farm Credit System.

In conclusion, it is important to note that the basis for our concern about the condition of the rural economy. The owners and customers of the Banks for Cooperatives live in rural areas. The banks themselves are solely dedicated to serving the credit needs of rural America. For those reasons the banks have a commitment to assist in bringing about the revitalization of rural economies.

The Farm Credit System and the Banks for Cooperatives have used existing economic development authorities prudently for the benefit of rural Americans. In considering the economic problems of rural areas, we urge you to look for solutions from the businesses and organizations that have a proven record of commitment in serving rural areas. The Banks for Cooperatives and our borrowers are operating successfully and profitably despite the persistent problems in the rural economy. For that reason the Banks for Cooperatives and the businesses we serve can be an important part of the solution.

Mr. Chairman, I commend you for holding these hearings. I would be happy to respond to any questions from committee members.

[The prepared statement of Mr. Cassidy, together with the articles referred to, follows:]

PREPARED STATEMENT OF JACK E. CASSIDY

THE NATIONAL BANK FOR COOPERATIVES AND RURAL DEVELOPMENT

Mr. Chairman, I appreciate the opportunity to testify today on behalf of the National Bank for Cooperatives.

My name is Jack Cassidy. I'm the Vice President for Corporate Relations with the National Bank.

The National Bank is a new multibillion-dollar bank formed on June 30 as a result of a nine-bank merger within the Farm Credit System. The Farm Credit System is a nationwide network of farmer-owned banks and associations.

When it begins operations on January 1, 1989, the National Bank for Cooperatives will offer a complete line of financing and related services to agricultural cooperatives, rural utility systems and other eligible borrowers. The bank will also finance agricultural exports and provide international banking services in support of U.S. farmer-owned cooperatives' international activities.

The nine Banks for Cooperatives that are merging to form the National Bank have a combined total of $8.2 billion in loans outstanding as of June 30, 1988. Based on that loan volume statistic, the National Bank will be the fifteenth largest U.S. provider of commercial credit to businesses.

Agricultural cooperatives and rural utility systems--and the credit programs they rely on--have a significant effect on the rural economy. For example, the 70 largest borrowers of the Banks for Cooperatives have total annual sales in excess of $33 billion and assets of $28 billion.

The Fortune 500 list of industrial enterprises includes 15 agricultural cooperatives--14 of which have a banking relationship with the Banks for Cooperatives. These 15 agricultural cooperatives employ about 60,000 people--nearly all in rural areas.

These statistics illustrate the important economic contribution being made by the borrowers of the Banks for Cooperatives. These numbers are also indicative of the role the Banks for Cooperatives could play in contributing to the revitalization of rural America.

My testimony includes information about the credit programs currently offered through the Banks for Cooperatives. Further, I will discuss several areas in which new authorities could be used to promote economic development while strengthening the Banks for Cooperatives.

CREDIT PROGRAMS PROMOTING ECONOMIC DEVELOPMENT

Rural Utility Financing--The Banks for Cooperatives have been authorized to finance certain rural utility systems for 15 years. That authority was expanded in 1985 when Congress authorized all the rural utility systems that are eligible to borrow from the Rural Electrification Administration to also borrow from the Banks for Cooperatives. The banks currently have about $3 billion in loans and commitments outstanding to 290 rural utility systems. Clearly, the Banks for Cooperatives have become an important supplemental source of credit for rural electric and telephone systems. These utility systems will provide the energy and communications technology for future generations of rural Americans.

Financing Subsidiaries of Rural Utilities—Under legislation approved in 1985, the Bank for Cooperatives were authorized to provide financing to subsidiaries that are owned by eligible rural utility systems. It is through subsidiaries that many rural utilities diversify their operations and create new economic activity in rural areas. These subsidiary operations may be as simple as developing local natural resources for the benefit of the parent or as high-tech as providing cellular telephone systems, cable TV or long-distance fiber-optic networks. In any case, subsidiaries owned by utility systems eligible to borrow from the Rural Electrification Administration are eligible to borrow from the Bank for Cooperatives.

Financing Partnerships and Joint Ventures--The Banks for Cooperatives were authorized by the Agricultural Credit Act of 1987 to provide financing to partnerships, joint ventures and similar entities that are controlled by eligible borrowers. This authority is already being used as farmer-owned cooperatives join in partnership with commercial enterprises to develop new business opportunities and create new jobs in rural areas. Rural economies need the capital and expertise resulting from cooperatives and commercial businesses joining together to form new enterprises that create new jobs in rural areas.

Community Development--The Department of Agriculture estimates America's 46,000 rural communities will require over $20 billion in capital expenditures to bring rural wastewater treatment facilities up to national standards. In the past, the Farmers Home Administration (FmHA) and other federal agencies have provided billions of dollars in grants and low interest loans to build or improve water and wastewater treatment facilities. However, current budgetary restrictions make it unlikely adequate amounts of federal assistance will be available in the future.

The Banks for Cooperatives have been able to meet some of the needs of rural communities by financing the prepayment of Farmers Home Administration community development loans at a discount. Many rural water associations, for example, serve a high percentage of farmers and are owned by their users. Such associations are eligible for loans from the Bank for Cooperatives.

Most small communities are not capable of obtaining a bond rating or acquiring long-term funds from traditional commercial lenders. The Banks for Cooperatives--with over fifteen years experience in financing rural utility systems--are in an excellent position to help address these credit problems for eligible borrowers.

Concurrent Financing--In the past, federal agencies--such as Farms Home Administration--have provided loan guarantees to private businesses that create jobs in rural areas. The Banks for Cooperatives have substantial expertise in financing rural businesses, but often are prevented from participating in such programs due to eligibility limitations. The banks have worked closely with the Rural Electrification Administration to provide joint or concurrent financing to rural utility systems. A similar arrangement with other federal agencies could have significant merit.

Loan Securitization--Authority to securitize loans made by the Banks for Cooperatives would better enable the banks to provide credit at competitive rates, manage risk and access a wider variety of investors. Such authorities are consistent with the powers exercised by other lenders. The System's borrowers would be the primary beneficiaries if the banks could securitize loans.

For example, loan securitization authority would enable the Banks for Cooperatives to group similar loans into a common pool and sell interests in the asset pool, thereby spreading risk and creating an attractive investment. Certain types of loans are ideal for securitization, such as loans to rural electric and telephone systems that are guaranteed by the Rural Electrification Administration, or agricultural export loans guaranteed by the Commodity Credit Corporation. Selling interests in a pool of guaranteed loans would maximize the benefit of the federal guarantee and result in lower interest rates for the borrowers.

Export Financing--The Banks for Cooperatives are the only U.S. lenders that make significant and consistent use of the Department of Agriculture's export loan guarantee programs. Most of the other lenders using the programs are foreign banks. It's ironic that American farmers must depend on foreign banks to finance the export of agricultural products.

Last spring, the Wall Street Journal reported that American exports were being hampered due to a lack of financing. An American banker was quoted as saying "One of the reasons the agricultural community can't export to [developing countries] is they can't get financing."

Last fall, the Washington Post reported on a speech made by the chairman of the U.S. Export-Import Bank. The news article was entitled "U.S. Banks Accused of Failing to Meet Needs of Exporters."

I would ask that copies of these two articles be made part of the hearing record.

While other commercial lenders have curtailed or eliminated their agricultural export financing operations to pursue more profitable endeavors, the Banks for Cooperatives recently reached a new record of $1.7 billion in export loans. Despite the rapid growth in this lending program, not a penny of principal has been lost.

Adequate financing must be a key part of any plan to increase agricultural exports. Adequate financing would improve the marketability of agricultural products and the health of rural economies. Clearly, the Banks for Cooperatives could make a greater contribution to promoting agricultural exports.

However, burdensome eligibility restrictions require a agricultural product to originate from and be owned by farmer-owned cooperatives until the product is delivered to the purchaser to be eligible for financing from the Banks for Cooperatives. This is nearly impossible for grain products that are fungible and that frequently change ownership between the country elevator and the final destination. Broader authority to finance American-produced farm exports could significantly improve the marketability of U.S. Agricultural products. It would also improve the balance of trade situation.

RURAL DEVELOPMENT FINANCING UNDER STUDY

Clearly, there is a growing interest on the part of the federal government and the farmer-owners of the Farm Credit System in promoting cost-efficient and job-creating economic development in rural areas. This interest has caused the Banks for Cooperatives to begin a staff-level study of innovative ways in which the banks can contribute to economic growth in rural areas.

One of the credit issues we believe needs to be addressed is the inability of most rural communities and cooperatives to access the types of commercial banking and investment banking services available to large corporations. The availability of these services would help rural communities and cooperatives to obtain needed long-term capital from national and international credit markets and make products produced in rural areas more marketable.

One idea under study would enable the Banks for Cooperatives to establish finance subsidiaries to provide investment banking and other services. These services could include the ability to underwrite and issue securities, offer trust services, take equity positions in rural enterprises and guarantee bonds issued by communities. One option would be to structure these finance subsidiaries so that they would obtain their loan funds from private credit markets instead of the federal agency market that is the traditional source of funds for the Farm Credit System.

I want to emphasize that this idea is in the study and discussion stage and we are interested in hearing the thoughts of interested parties and federal officials.

CONCLUSION

In conclusion, it is important to note the basis for our concern about the condition of the rural economy. The owners and customers of the banks for Cooperatives live in rural areas. The banks themselves are solely dedicated to serving the credit needs of rural America. For those reasons, the banks have a commitment to assist in bringing about the revitalization of rural economies.

The Farm Credit System and the Banks for Cooperatives have used existing economic development authorities prudently for the benefit of rural Americans. In considering the economic problems of rural areas, we urge you to look for solutions from the businesses and organizations that have a proven record of commitment in serving rural areas. The Banks for Cooperatives and our borrowers are operating successfully and profitably despite the persistent problems in the rural economy. For that reason, the Banks for Cooperatives and the businesses we serve can be an important part of the solution.

Mr. Chairman, I commend you for holding these hearings. I would be happy to answer questions from committee members.

Elusive Lenders

Financing for Exports Grows Harder to Find For All but Big Firms

Most Banks Give Up Business As Unprofitable, Risky; Irving Trust Bucks Trend

Why Trade Gap Stays So Big

By PETER TRUELL
Staff Reporter of THE WALL STREET JOURNAL

When Jernigan Trading Co. of Knoxville, Tenn., wanted to sell white oak and black walnut to Western European furniture makers, it spent a year and a half looking for a bank interested in financing exports.

During that time, it nearly had to close up shop. "We had no credit lines," recalls Victor Jernigan, the company's president. He says that nine Southeastern banks turned him away because they didn't do such business. "It's those auto loans that banks want to do," he says. "Export trade isn't in fashion now."

Finally, after a pair of thousand-mile round trips to Baltimore, Mr. Jernigan got a $500,000 loan from Maryland National Bank.

For small and medium-sized companies all over the U.S., finding banks to finance and guarantee exports has become much more difficult. Over the past few years banks have largely given up such business. "Obtaining export finance is probably one of the most difficult things an exporter is confronted with," says Michael Rice, an executive vice president at Irving Bank Corp., whose Irving Trust is one of the few major New York-based banks that still court smaller exporters.

Hampering Efforts

The change is hampering potential exporters' efforts to capitalize on the weaker dollar. It also helps explain why it is taking so long to reduce the huge U.S. trade deficit, which last year widened to $169.8 billion from $148.5 billion in 1985. Small and medium-sized companies are estimated to account for one-third of U.S. exports.

Exporters usually seek bank financing to guarantee payment for the goods they sell overseas or for working capital to produce goods. Unless an exporter is among the biggest in the country, it requires bank help, says H. Jurgen Schlichting, who manages Westdeutsche Landesbank Girozentrale's New York office.

But from small regionals to money-center behemoths, banks are passing up export-related business as insufficiently profitable and too time-consuming and risky. The strong dollar of a few years ago and the world debt crisis persuaded many banks to cut back or close international and export-finance departments. Now, their trade-finance departments mostly survive on import financing, and they prefer to concentrate on investment banking and retail customers.

Pumping Gas

"The expertise in the banks has vanished. I don't know what's happened to those guys. I guess they're pumping gas or selling old ladies Visa and MasterCard," says Charles Zemene, the commercial finance director at Terex Corp., a heavy-equipment manufacturer in Hudson, Ohio. He used to work in Chase Manhattan Bank's trade-finance department.

"Banks generally have considerably reduced their export-financing capabilities and marketing efforts," says George Cashman, the vice president responsible for trade finance at Morgan Guaranty Trust Co.

Like most other big U.S. banks, Morgan has dismantled most of the costly framework that helped it provide companies with export-finance services. "Ten years ago we had a large group that [sold services to] domestic companies and spent a lot of time educating U.S. companies about how we could assist them to export," says Mr. Cashman. But, he says, there just wasn't enough profit in such business. So Morgan, setting a trend, turned its U.S. export-finance department into a consultancy for financing very large foreign projects and turned its attention to financing exports in Britain and other countries where such services are more profitable.

Economic Basis

"The U.S. has never recognized that other countries do things to make export financing attractive to their banks," Mr. Cashman says. Adds a trade-finance specialist at a big money-center bank: "For there to be a resurgence of U.S. bank interest in supporting exports, there has to be an economic basis for it."

In the meantime, Terex's Mr. Zemene says the company often can't match the financing packages offered by its foreign competitors. Its bankers aren't interested in winning such business, he says. Japan's Komatsu Ltd. recently won $5.6 million in contracts to supply heavy trucks to Mexico and Chile with financing packages from Japanese banks that Terex couldn't match, Mr. Zemene says.

In Hardwick, Mass., Marc Villa, the president and treasurer of North Atlantic Timber & Shipping Co., says: "It's hard for a small company. There's a major Catch-22 involved. You need export insurance to get financial expertise, but in order to get export insurance you need financial expertise." Mr. Villa's company has annual sales of between $10 million and $12 million, mainly of oak, ash and cherry to furniture makers in the Far East, Europe and the Mideast.

Roscor Corp., a family-owned business in Mt. Prospect, Ill., won a $5 million contract to build television trailers for the

Please Turn to Page 14, Column 1

Elusive Lenders: Companies Find Export Financing Hard to Obtain

Continued From First Page

South Korean Olympics, its biggest order to date. It managed to complete the order with the help of loan guarantees from the U.S. government but found that it had to do most of the export-finance work itself because of a lack of local bank expertise.

"If the bank had known more about it, that would have helped us," says Mitchell Roston, a Roscor vice president. Enviously, he recounts how Japanese banks in the Midwest hold regular meetings to help Japanese companies win export business and how smaller Japanese companies are allowed to band together to win export contracts.

The problem is particularly bad for those that export to developing countries, which are often mired in billions of dollars of foreign bank debt. In El Dorado, Kan., it used to be straightforward for International Petroleum Services Inc. (annual sales: $12 million to $20 million) to borrow money against a letter of credit when it sold oil equipment to a country in Asia or Latin America. Now it's "like pulling teeth," says Richard Teichgraeber, the president. "One time we had even completed the order before we got the financing."

Following Morgan Bank's path, Chase has cut its export-finance staff by about two-thirds and turned it into a consultancy that sells advice and services, mainly to large companies and other Chase units.

Scaled-Down Operation

Chemical Bank closed its global-trade-finance group at the end of 1985, though a Chemical spokesman says that the bank now offers export finance through other departments. The unit used to have offices in New York, Los Angeles and Chicago. San Francisco-based Bank of America "scaled down its whole operation in May 1985," a spokeswoman says. Bankers Trust Co. has cut back its staff in this area but continues to finance large exports, according to Lawrence J. Brainard, a senior vice president and the bank's chief economist.

For at least one small exporter, such changes meant running a gamut of banks that didn't want his business. Roy V. De Mellio, who runs Offshore International Ltd., a New York textile factoring company, tried to get trade credit to finance the apparel and fabrics he exports to Latin America. Despite more than 20 years in factoring, or buying accounts receivable, he says, he was turned down by Bankers Trust, Chemical, Chase, Citibank and others. Fortunately for him, he caught the eye of Alfred F. Daiboch, a Bankers Trust lending officer. When Mr. Daiboch switched jobs to head trade finance at the New York branch of Italy's Banca Nazionale del Lavoro, he financed Mr. De Mellio's business.

A few U.S. banks still court export-finance business, including Maryland National, First National Bank of Maryland and Pittsburgh National Bank. Among big banks, Irving Trust is pursuing a dogged individual strategy. Mr. Rice, who was recruited from Chase to lead Irving's trade-finance business, says, "Irving senior management has said trade finance will be important in the longer term. It's definitely against the trend, but I think that trend will reverse in the next 12 to 18 months" as the need for financing grows and the understanding of the problem improves.

Meanwhile, foreign banks are doing some small-export financing. "The foreign banks are all trying to find a niche in this market, and the exit of the U.S. money-center and regional banks from export finance has provided us with that niche," says Malcolm Koch, a trade-finance specialist at DG Bank of West Germany in New York. Mr. Koch, who once worked for Chemical Bank, is—like Mr. Daiboch—part of a widespread shift of experienced U.S. export financiers to foreign banks.

The foreign banks—particularly those from West Germany, Japan and Britain—now provide about a third of the export credit granted in the U.S., according to trade-finance experts.

But the foreign banks are only picking off selected business. According to bankers and exporters, these banks are usually eager to land major customers and are often interested only in financing exports to countries near their home bases. They are leery of financing agricultural exports to developing countries. "One of the reasons why the agricultural community can't export to [developing countries] is they can't get the financing," says William Anderson, the head of international operations at First National Bank of Minneapolis.

Even big companies have trouble getting financing for exports to debt-ridden countries. One is the Wabco unit of Dallas-based Dresser International Corp., a heavy equipment maker with 1986 revenue of $3.66 billion. Says Frank Calvert, the export-finance manager: "Zambia, the Philippines, Chile and Brazil: Those are the most difficult ones for us. For Latin America, it's difficult to find a financial institution to do the coverage."

Recent Federal Reserve Board statistics indicate the extent of U.S. banks' retreat from export finance in developing countries. Outstanding trade finance lent by U.S. banks to Asia, Latin America and oil-exporting countries totaled $37.7 billion at the end of the 1986 third quarter, down 12% from $43.1 billion six months earlier.

But getting financing for exports to Europe can be difficult, too. When Mr. Calvert wanted to get bank guarantees for a recent equipment sale to Yugoslavia, he had to turn to the New York branch of Spain's Banco Atlantico S.A. His local banks wouldn't touch the business, he says.

Bankers don't apologize for their withdrawal from export finance. Frank Graebner, a trade-finance specialist at the Chicago office of Britain's National Westminster Bank, says that on typical government-backed export-credit business, U.S. banks make a 1 1/2 percentage point interest margin on guaranteed loans. He notes that they can make more money lending locally on mortgages.

Government officials say that they recognize the difficulties. "Trade finance has fairly high overheads and traditionally has artificially high cost attribution, making it a difficult business to justify under present substantial pressure to make profits," says John A. Bohn Jr., the chairman of the Export-Import Bank, a government agency that helps finance exports.

The legislative and regulatory areas don't offer much hope to small and medium-sized exporters. The 1986 tax law contained new roadblocks for banks getting involved in financing exports. The law reduces the amount of foreign tax credits that banks can use to offset U.S. taxes on income from foreign loans, including export credits.

And pending new Fed capital requirements would make trade finance more capital-intensive. That, bankers say, would further discourage export financing, as banks would be reluctant to devote more capital to an area that they have recently deemphasized.

House Panel Approves Bill To Keep Fairness Doctrine

By a WALL STREET JOURNAL Staff Reporter

WASHINGTON—The House Energy and Commerce Committee voted 33-5 to put the fairness doctrine into law, with approval by the full House expected soon.

The doctrine, a Federal Communications Commission regulation, requires broadcasters who run controversial material to give opponents airtime to respond. The Senate already has passed a similar measure.

A U.S. appeals court ruled last fall that the doctrine, which dates back to the early days of television, hadn't been specifically required by law. That freed the agency to repeal the rule, but congressional supporters of the doctrine have moved to forestall any FCC action by making the regulation a law.

Fairness doctrine proponents argue that it increases the diversity of opinion expressed on television and radio. But critics contend that it inhibits broadcasters from airing controversial shows because they fear they might be required to give free airtime to opponents.

U.S. Banks Accused of Failing to Meet Needs of Exporters

By Beatrice Motamedi
United Press International

SAN FRANCISCO, Sept. 16—A top federal trade official today accused major U.S. banks of failing to meet the needs of American exporters attempting to sell their goods in foreign markets.

"We are finding some foreign banks of one country financing exports of the United States to a third country," said John A. Bohn Jr., chairman of the U.S. Export-Import Bank.

"They're essentially prepared to take the risk of those markets more than [is] the American side," Bohn told the President's Export Council, holding its semiannual meeting in San Francisco.

Bohn said that foreign banks have frequently shown more enthusiasm for U.S. government trading programs than have American banks.

"If it moves a U.S. export, so much the better," said Bohn, whose agency supports trade by offering export financing, guarantees, insurance and low-cost loans.

Bohn said deregulation, the erosion of the barrier between commercial and investment banking, and the Latin American debt crisis have "badly shaken" the U.S. banking system.

Bohn said major banks now face "intense pressure" to boost their equity capital instead of financing risky projects abroad.

"The trade business does not produce the quick-profit, high-glamor kind of stuff that Wall Street does," Bohn said, adding he believes there is a lack of talented bankers working in the area of international trade.

Bohn said regional banks, which increasingly "outperform" major money center banks, are mindful of the Federal Reserve Board's focus on capital adequacy and are thus reluctant to finance trade deals, except "for very important clients."

Bohn also said he expects the U.S. trade deficit, which rose to a slightly worse-than-expected $16.5 billion in July, to show some improvement in September or October. He predicted exports of transportation equipment, especially aircraft, communications equipment and perhaps agriculture will be up in the fall.

Others at the meeting of the council, a group of top-level industry executives that advises President Reagan on trade matters, voiced frustration over a variety of American exports from fish to high-tech electronics.

Trade officials from California and Alaska, whose economies are heavily dependent on exports, said state industries need more support from the federal government and from U.S. negotiators at an international round of trade talks taking place under the General Agreement on Tariffs and Trade in Geneva.

"California firms need to achieve real progress in the new round [of talks]," said Robert D. Kleist, president of the California Council for International Trade, citing barriers to exports of high-quality California farm crops.

Alaska's salmon industry needs research and development money to fend off competition from government-subsidized fish farmers in Norway, said John A. Smith, commissioner of the Alaska Department of Commerce and Economic Development.

Reports of unfair Japanese trading practices in the area of electronics got support from an unlikely source: Japanese-born Aki Sato, president of NASAM, the U.S. trading arm of Cleveland-based Banner Industries.

In a comment that elicited appreciative chuckles from a mostly American audience, Sato complained of "invisible politics, invisible practices" that have hampered his efforts to promote exports of U.S. high-technology and military equipment, such as aircraft, missiles and satellite parts.

Senator **Bingaman**. Thank you very much.

Why don't we go right ahead with Mr. Larochelle. Is that the correct pronounciation?

Mr. **Larochelle**. That is correct. Yes, Senator.

Senator **Bingaman**. Mr. Larochelle with the National Rural Electric Cooperative Association.

Why don't you go ahead with your testimony.

STATEMENT OF RICHARD LAROCHELLE, LEGISLATIVE REPRESENTATIVE FOR RURAL AND ECONOMIC DEVELOPMENT, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

Mr. **Larochelle**. Thank you, Senator.

I appreciate the opportunity to be here today to discuss the important matter of access to capital in rural communities and its importance to economic development.

I have a prepared statement that I would like to submit and, as the last speaker, I wuld like to summarize that as briefly as possible.

Senator **Bingaman**. That would be great.

Mr. **Larochelle**. First of all, let me mention that Mr. Bergland, our executive vice president, asked me to express his disappointment to the committee that he was not able to be here today. He had another commitment, but many of the ideas in this testimony are his ideas and based on his leadership.

NRECA is the national organization for 1,000 rural electric cooperatives. They are in 2,600 rural counties. Their lines cover about 70 percent of the land mass of the country. They serve about 25 million people.

Each cooperative is governed by a board of directors that is elected by the people that receive electricity from the co-op and in fact own the co-op. These local boards establish policies for the co-op and they direct the co-op to get involved in economic development activities beyond the provision of electric service.

Attached to my statement is a brief publication that we recently completed entitled "Strengthening the Rural Economy." That gives some 25 examples of these kinds of activities, including providing financing assistance to local small businesses.

A recent survey of the Department of Agriculture concluded that over 150 rural electric and telephone systems during 1987 provided this financing assistance in their local communities.

We at the national level have focused more attention on this recently, however these are activities that co-ops have been doing quietly and on a small scale for many years. Because of the serious problems during the 1980's, many of which, including out-migration, were discussed earlier, the involvement of electric cooperatives in these local development efforts have increased.

I would like to touch on three major points. First, is there a credit gap in rural communities? Second, some recent legislative initiatives to address this problem, and, third, some of the ideas of Bob Bergland and NRECA on new congressional initiatives needed.

On the issue of whether there is a credit problem, we have been hearing for the last 4 or 5 years from our own rural electric managers across the country and their economic development staffs cases of small business people with sound business plans, good ideas, unable to get financing. This is anecdotal evidence, but to us it has been very personally persuasive.

Recently, there have been a few research studies which have confirmed some of these anecdotal reports. There was a study presented in August at the American Agricultural Economics Association meeting, completed by three economists. I would just like to read the conclusion of that study.

"After adjusting for firm specific risk, there are rural capital markets in which financing difficulty is correlated to non-risk-related characteristics. This is evidence that firms in some local markets have inadequate access to business financing."

Now, this particular study was based on an indepth analysis of the credit markets in the State of Wisconsin, basically saying that when you take away the factor of risk there are rural markets in which small businesses can't get financing. Our own evidence and the reports we get back is that the situation in Wisconsin is not unique, that that exists in some other places across the country—particularly in the case of businesses expansion and for long-term financing.

An additional statistical factor that indicates that there are some kind of structural problems going on here is the fact that during the 1980's the rate of new business formation in rural communities has been far, far below the rate in urban areas.

Because of all these problems, the Congress in the Reconciliation Act last December, included two small amendments to the Rural Electrification Act, both of which permit rural electric cooperatives to get more involved in providing financing and in plugging some of the credit gaps in their areas.

The first of these permits rural electric co-ops to make investments in nonelectric facilities or provide guarantees for these purposes up to 15 percent of the amount that they have invested in their electric facilities. Nationally, this will make available billions of dollars potentially. NRECA has been advising our membership that they ought to be conservative about this and go slowly and base such investments on careful feasibility studies.

Nevertheless, this does open up the potential for significantly large amounts of capital into rural communities.

The second provision created a small program to provide grants and zero interest rate loans, basically for seed capital for rural development projects. This new fund is financed through the advance payments of rural electric and telephone cooperatives. They accept a below market—5 percent—return on these deposits—advance payments. The difference between the 5 percent interest that the co-ops get and the cost of money to the Government funds this rural economic development subaccount.

This is a small pool of money, but we feel that it is important. Our evidence is that it is often the small amounts of capital, capital in the range of $5,000 to $50,000, that small businesses have a hard time getting. These small amounts can make the difference between a good idea in a rural community dying on the vines and becoming a new business enterprise that creates jobs in that community.

We recognize that the rural electric cooperatives certainly can't do it all in terms of providing financing for rural communities. They will be relatively minor players in this area, but we feel that the problem is serious and that all rural institutions that can play a constructive role ought to be encouraged to do so, and that is the approach we have been taking with our own membership.

The final point I would like to make is to briefly explain one of the ideas of Mr. Bergland with respect to expanding the role of the Rural Electrification Administration beyond rural electric and telephone financing. This idea basically has two points.

He has proposed that REA, which now is limited to providing financing for electric and telephone facilities, be able, be permitted to provide funding for other rural development projects—business development and infrastructure projects.

The second part of that proposal is that such financing be combined with the requirement that rural electric cooperatives put together financing packages which leverage a small amount of government capital, Federal capital, with greater amounts of private capital. We feel that this initiative is one innovative way to trying to leverage a small amount of Federal funds, trying to get capital out into rural areas, particularly in cases where financing is not available through other commercial sources. We feel that this new proposal is a way of doing this and a way that minimizes the Federal cost and minimizes the Federal involvement.

Our experience in economic development has been that any project to be successful must include local leadership, local commitment, and local investment. We don't believe that economic development can be done from State capitals. We don't believe it can be done from Washington. We think State governments and Washington have a role in this, but it is mainly to leverage what other organizations, private organizations like rural electric co-ops, local development corporations, and others, can accomplish.

That concludes my statement. Let me say that we appreciate the attention that this committee is giving to this important problem, and we would be happy to cooperate and to assist you in any way possible.

Thank you.

[The prepared statement of Mr. Larochelle, together with the publication referred to, follows:]

PREPARED STATEMENT OF RICHARD LAROCHELLE

Mr. Chairman and Distinguished Members of the Committee:

I appreciate this opportunity to appear before you today to discuss the importance of capital availability to the economic health of our rural communities, and to suggest possible options to increase the availability of capital in order to promote rural economic development.

NRECA is the national service organization for the 1,000 rural electric systems which provide power to 25 million people in 2,600 counties in 46 states. Each rural electric cooperative is owned by its consumers who elect a board of directors to set policy and guide the cooperative in its service to the community. By their very nature, rural electric systems have both deep roots and a vested interest in ensuring that their communities grow and prosper.

Today rural electric systems are involved in a wide variety of economic development activities beyond the provision of electric service. This fact is illustrated in a brief publication which is attached to this testimony and is entitled Strengthening the Rural Economy: America's Rural Electric Systems at Work. This publication includes some 25 examples of local projects, (including financing assistance to local small businesses), in which rural electric systems have worked with others in their communities to provide development assistance. Our purpose in developing this publication was to use it as an "idea sharing" vehicle among rural electric cooperatives and other rural organizations. I hope that the Committee will also find it to be of value as an illustration of some of the things that can be accomplished by local grassroots organizations like rural electric cooperatives.

With respect to the issue of the availability of credit to rural communities, I would like to: (1) explain our understanding of the nature and importance of this problem; (2) discuss recent legislation which now permits rural electric cooperatives to provide greater assistance to their communities in providing funding for needed projects; and (3) offer for your consideration some suggestions for new Congressional initiatives which can help to close the credit gap facing some of our rural areas.

The Problem of Access to Capital in Rural Areas:

Lack of access to capital poses a substantial deterrent to rural economic development in many rural communities. This is particularly true for businesses seeking capital to start up or expand their operations. Evidence of this comes from several sources. The first of these, and the most personally persuasive to us, is the first-hand reports of our rural electric managers and their economic development staffs across the country. These reports, which we have been receiving for the past four to five years, tell of the difficulties of small business people with good ideas and sound business plans of attracting sufficient capital to get their enterprises off the ground or to expand their operations. These reports lead us to conclude that a credit gap exists in many rural areas and that this gap is a significant deterrent to new business formation and to rural economic growth.

We are concerned that bank deregulation may be a contribution to this problem. In some cases the disappearance of small independent rural banks and the consolidation of rural banks into larger entities dominated by urban interests may be resulting in a net disinvestment in rural areas. In these cases deposits made at rural branches of large banks are "vacuumed" out of rural areas and used by these regional banks for investments in urban areas. We are particularly concerned by this situation because it appears that a number of structural factors could serve to perpetuate or accelerate it. These factors include: (a) the feeling that loans made to rural businesses may be higher risk because of the wider cyclical trends and greater international competition associated with the dominant industries of rural America -- agriculture, mining, and low skill manufacturing; (b) the perception that a rural loan portfolio, even if profitable, is unlikely to provide as high a return as a portfolio comprised primarily of loans to businesses in faster growing urban and suburban areas; (c) the fact that loans to rural businesses are, on average, smaller in size and therefore involve greater transaction costs; and (d) the relative unfamiliarity of managers of large consolidated banks with the economic conditions of less populated rural branch areas, and the fact that management, given limitations on their time and a desire to achieve the greatest returns, may not view rural areas as high priority areas for their marketing attention.

Recently, statistical data and research studies have become available which lend support to the anecdotal evidence we have been receiving. A research paper entitled Adequacy of Capital Markets for Rural Nonfarm Businesses was presented in early August of this year at the Annual Meeting of the American Agricultural Economics Association. This paper (completed by three researchers, two of them professors of economics at the University of Wisconsin-Madison) was based on a detailed study of rural credit markets in Wisconsin. Its conclusion was that:

> "After adjusting for firm specific risk, there are rural capital markets in which financing difficulty is correlated to non-risk-related characteristics. This is evidence that firms in some local markets have inadequate access to business finance."

The study found that these problems were particularly serious for small firms without access to non-local markets and for those firms seeking longer term debt.

An additional factor which indicates potential problems in access to capital by rural businesses is the rate of new business formation. During the 1980s, the rate of rural business formation has been far less than for urban areas. Researchers have concluded that this gap suggests the existence of structural factors -- such as inadequate access to capital -- which are impeding rural business formation.

1987 Amendments Authorized Greater Role for Rural Electric Systems:

Last December Congress paved the way for greater direct involvement by rural electric systems in financing economic development projects. The Omnibus Budget Reconciliation Act, signed by President Reagan on December 22, 1988, included two amendments to the Rural Electrification Act which provide rural electric systems with new latitude and new tools to provide greater assistance to their local communities in improving access to capital.

The first of these amendments was a provision which permits rural electric systems to use their own funds or make guarantees for investments in rural development projects, provided that the total of such investments may not exceed 15% of a system's investment in its electric utility facilities. The previous limit was 3%. The amendment provides that the decision as to how, whether, and under what circumstances to use this new authority will not be dictated by the Rural Electrification Administration (REA) -- it will be determined by each local rural electric cooperative based on local circumstances and needs.

The second provision amended the Rural Electrification Act to create a small fund to be used as seed capital for economic development projects. Under this provision, REA is required to encourage its borrowers to voluntarily make payments ahead of schedule. Such payments generate interest at 5 percent to the REA borrower, and the difference between this 5 percent rate and the cost of money to the REA Revolving Fund (now averaging about 11%) is placed in a separate subaccount -- the Rural Economic Development Subaccount -- to be used in making grants and zero interest loans as seed capital for economic development projects.

The Administration has proposed (but not aggressively worked for) the repeal of both of these new programs. However, bipartisan Congressional support for these provisions is strong and the case for their elimination appears very weak, because both of these provisions are based primarily upon private organization, rural electric cooperatives, using their own funds to promote the development of their local areas.

The status of these two new programs is that to date REA has not yet issued rules to implement either of these programs. In the case of the "15% Use of Funds" provision, this failure has not been serious, because the Agency has made it clear that, even in the absence of regulation, any borrower is free to provide funds for rural development projects, based on the legislative provision. In the case of the "Cushion of Credit" program, REA's failure to issue regulations has meant that no grant or loan funds have been made available from the Rural Economic Development Subaccount as seed capital for local development projects. REA management has informed us recently that a draft of the regulation to implement this program has been completed and will soon be sent to the Federal Register.

Proposed New Initiative: Broaden REA's Authority Beyond Electric and Telephone Financing:

With respect to new Congressional initiatives to assist rural communities in closing the credit gap, I would like to cite the concept proposed recently by Mr. Bob Bergland, NRECA's Executive Vice President, in testimony before the Small Business Committee of the United States Senate. Mr. Bergland proposed that legislation be enacted to broaden REA's financing authority beyond the areas of electric and telephone service. Under this proposal, REA could provide funding for infrastructure and business development projects; but this new authority would be combined with the requirement that REA borrowers put together financing packages which leverage these federal funds with private capital, including use of funds of the electric and telephone systems. This new authority would complement the two provisions of last year's Reconciliation Act, and build upon the public-private partnership which has been extremely successful in bringing electric service to rural America.

NRECA recognizes that rural electric systems alone cannot solve the problems of access to credit in our rural areas. However, the problem of credit availability is a serious one which, if not solved will greatly impede any rural jobs creation initiative. This problem calls for innovative solutions and the involvement of all rural institutions that can play a constructive role.

According to REA data, more than 150 rural electric and telephone systems provided assistance in arranging or providing financing within their service areas during 1987. Mr. Bergland's proposal to broaden REA's authority in this area would enhance this effort by making REA an effective partner in the effort to close credit gaps in rural communities. This initiative would provide an effective method of leveraging a small amount of federal funds with larger amounts of private capital in order to promote rural business formation and expansion and thereby create employment opportunities in rural communities.

NRECA believes that it is in the best interest of our entire nation to foster a vibrant rural economy. Rural america constitutes a tremendous national treasure which must be developed and utilized as this nation continues its economic transition toward greater concentration on technology and service-based industries. While the cost of assisting rural America in this transition must certainly be weighed, we believe that the cost of permitting Rural America to be "left behind" is too great in both economic and social terms.

Innovative solutions which are based on public-private partnerships minimize the costs to the Federal Government; and those which leverage public capital with greater amounts of private funds -- solutions like that proposed by Mr. Bob Bergland in suggesting that REA's authority be broadened -- should be among the options considered to increase the availability of rural credit and promote the viability of our rural communities.

NRECA commends this Committee for its leadership role in focusing much needed attention on this important problem. We offer our full support and assistance.

STRENGTHENING

the rural economy

AMERICA'S RURAL ELECTRIC SYSTEMS AT WORK

STRENGTHENING

the rural economy

AMERICA'S RURAL ELECTRIC SYSTEMS AT WORK

This publication contains a sampling of the efforts to strengthen and diversify the rural economy. We have provided snapshots, a glimpse of what's happening—and can happen—in the countryside.

America's rural electric systems are proud of their role in these efforts. Sometimes the co-op is involved from the beginning and actively participates in every phase of a community development project. In other instances, the co-op is part of the support system, quietly paving the path to success. In every case, the role of the co-op is guided by the wants and needs of the consumer-owners.

Our thanks go to all who gave of their time to share, in words and photography, the stories of their communities. With their help we've been able to demonstrate the broad and diverse range of the important efforts to strengthen the economy and improve the quality of life in rural America.

TABLE OF CONTENTS

Infrastructure: Foundation for Growth 1–3

- Fire Protection Saves Lives and Dollars
- Local Electric Co-op Builds and Operates Water System
- Improving Oklahoma Schools With Satellites
- An Advocate for Better Health in Rural Texas
- Water Line Will Promote Growth in Southern Indiana
- Sweat Equity Rebuilds Houses in Rural Wisconsin

Community Leadership 4–7

- Discovering Local Assets
- Essential Services Unite in Missouri
- The Other Side of the Mountain
- Beginning at the Beginning
- Providing Training in Economic Development

Attracting Industry 8–13

- Profile of a Professional
- Tokico Construction Underway in Kentucky
- A New Industry for Tabor, South Dakota
- A Leader in Economic Development
- Creative Financing for Business
- A "Spec" Building in Iowa Expands Economic Base
- South Carolina's Award-winning Efforts
- Joining Forces in Michigan
- A State Developer's Perspective

Helping Local Business 14–17

- Made in the USA
- Economic Development Rate Approved in Indiana
- Tourism in West Tennessee
- The Business Incubator

Business as Usual 18–21

- Improving Paradise
- Helping Consumers Help Themselves

The Art of the Possible 22

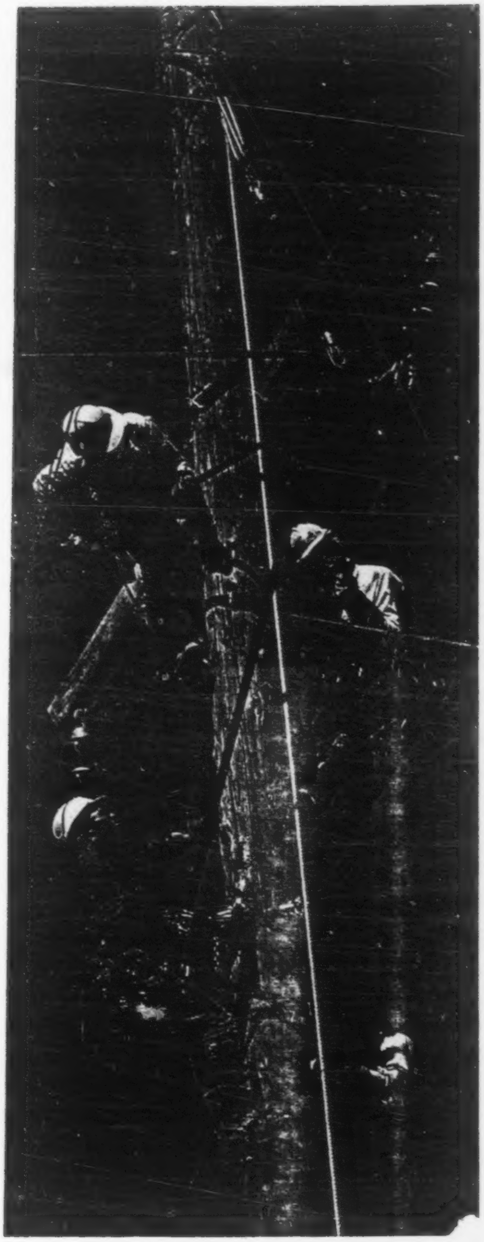
For more information, contact:

Dan Kamerman, Manager, Economic Development

Richard Larochelle, Legislative Representative, Economic Development

National Rural Electric Cooperative Association
1800 Massachusetts Avenue, N.W.
Washington, D.C. 20036

(202) 857-9500



Rural electrification stands as one of America's economic development success stories.

There was a time not long ago when only ten percent of the countryside had electricity, and there was little hope for change, until, in 1935, the federal government formed the Rural Electrification Administration (REA) to provide financing and technical assistance.

Rural people matched this effort in "sweat equity." They were the ones who organized their neighbors and began the difficult job of stringing the wires across the countryside, actually running their own rural electric cooperative. Today, as a result of this "experiment," there are 1,000 consumer-owned rural electric systems in the United States providing reliable electric service for 25 million people.

Local people own and control their electric systems. They elect the board of directors who sets policy and guides the cooperative in its service to the community.

The work of rural electrification has consistently attracted highly qualified leaders, people who are likely to be deeply involved in other leadership roles. They are church deacons, school board members, government officials, directors of banks and service organizations or any of a number of institutions that make up the fabric of the countryside. They are community leaders, and many community improvements and rural development projects are the direct or indirect result of their leadership and the co-op's involvement.

The fact is that rural electric distribution systems are experts in cooperation at the local level, and their work is buttressed by their state, regional and national alliances. Their memberships in statewide associations, the generation and transmission cooperatives (G&Ts), and the National Rural Electric Cooperative Association (NRECA) extend the spirit and strength of cooperation. Together it's quite a network, one adept in working with government agencies, universities, corporations and nonprofit organizations.

Characteristics of Success

Through trial and error, we have identified some of the characteristics of successful economic development projects.

- We've found that generally the most beneficial and long-lasting results are achieved by starting out small. It is often more realistic to undertake a project that results in a few jobs rather than expend energy and resources pursuing a large employer. Small successes can snowball into more small successes which build local vitality.

- We've learned that the success of any rural development effort depends on the leadership involvement and commitment of the local people and organizations. Without grassroots support, no government program or any other effort, no matter how well intentioned, is likely to succeed.
- We've found that the "can do" attitude is essential to rural development. Those who are easily overwhelmed and resort to an "ain't it awful" outlook are bound to reap more of the same. Those who succeed are people who can take that first important step forward.

We're all painfully aware that the economy of far too many rural areas remains depressed, still suffering from failures in agribusiness, mining and energy-related industries. The economic turnaround common to many urban locations, particularly along the nation's coastlines, is seldom found in rural America. As the economy undergoes major transitions, the danger that rural America will be left behind is real. The trend is there, but this does not have to continue. Local organizations can work together, accurately assess their communities' needs and assets, tap the necessary public and private resources, and roll up their sleeves to get the job done.

We in the rural electrification program have deep roots and a sincere and vested interest in improving the quality of life and the economic condition of the communities we serve. We are ready and willing to continue joining in partnerships with others, to work toward a revitalized rural America.

I salute the economic development work of rural electric systems around the country and hope as you read this booklet you will come to share our pride in the work now underway, as well as our confidence in a greater number of success stories in the days to come.

Bob Bergland
Executive Vice President and General Manager
National Rural Electric Cooperative Association

INFRASTRUCTURE: FOUNDATION FOR GROWTH

Fire Protection Saves Lives and Dollars

"How many half-burned buildings have you seen in rural areas?" asks Ernie Faucett, director of development for Arkansas Electric Cooperative, the statewide association of electric co-ops in Arkansas. "Mostly it's a pile of rubble with a chimney left standing. We want to see our people go to sleep at night with the same feeling of security and comfort as their city neighbors."

That in a nutshell is why Faucett got involved in developing a highly successful program to bring fire protection to rural Arkansas. And he asked a lot of tough questions along the way. Of the State Insurance Commissioner, he asked how many households would be affected, and what would the average savings per household be if there were fire protection in rural Arkansas. The answer: 200,000 households at $80.00 savings per year.

"Now, multiply $80.00 by 200,000 households and that is $16 million annually that would remain in the pockets of Arkansans instead of being paid to an out-of-state fire insurance company. *That* is economic development," says Faucett, recalling that this was the basis for gaining wide support as well as enabling state legislation for the comprehensive plan.

For fire trucks, U.S. surplus vehicles were brought up to mechanical standards and painted by prisoners at a State Department of Correction facility, then sent on to the State Forestry Department to be equipped with tanks, hose reels and ladders.

The statewide scope of the program allowed all counties to use a common system, so training and equipment were standardized.

In the beginning, Arkansas had only 50 rural fire departments. Today, ten years later, there are more than 900.

"We want to see our people go to sleep at night with the same feeling of security and comfort as their city neighbors."

The statewide association has also been deeply involved in developing water systems for rural Arkansas. Providing needed services like fire protection and safe drinking water takes a lot of time and effort. "They're not what I'd call glamorous programs," says Faucett, "but if you work hard to provide these services, you will create a fertile area for long-range residential and industrial growth for years to come." ■

Local Electric Co-op Builds and Operates Water System

The results of the Bullock county survey were clear. The people of this rural Alabama area wanted a water system, and Dixie Electric Co-op took on the job. With the help of the co-op, the water system, which served 500 consumers in 1975, now has more than 2,000 people on line.

"It makes good sense for Dixie to help the people in Bullock County," says former Manager Jim Vann. "Dixie's business organization—its billing procedures, its operation and maintenance facilities—help reduce the cost of providing water."

Funding the four million dollar water system was a complicated process involving ten separate funding applications and five federal agencies, each with different funding procedures and legal requirements. "It became evident to us that there's myriad opportunities, but at best, most communities do not have the expertise to avail themselves of these federal funds," says Vann.

Dixie constructed the water mains and continues to administer, operate and maintain the system under contract with a local water authority. The people working on the water line are the same people who climb the poles and run the electric co-op.

This arrangement just plain makes sense, according to Vann. "As the consumers have needs, it's logical to use the rural electrics to assist in this and other economic and rural development efforts." ■

Improving Oklahoma Schools With Satellites

Classes by satellite are now available at all 23 high schools in Cotton Electric Co-op's service area in southwestern Oklahoma, thanks to the co-op's contribution of satellite dishes.

At Indiahoma High, limited resources forced a choice between buying some computers or a satellite antenna, so the offer from the co-op was "like asking a man dying of thirst if he wanted water," recalled Superintendent Gary Tyler.

The school also faced the transfer of students and state aid to other schools offering language courses. Now by setting up cooperative arrangements with other schools and by using the new satellite dish, Tyler can offer three foreign languages. "How many high schools with 245 kids can say: 'We can offer you German, French or Spanish?'"

Helping rural schools stay competitive is an example of how co-ops can continually apply their imagination, creativity and organizational skills to today's concerns while making a tremendous investment in the future. ■

COURTESY
OF
ELECTRIC

An Advocate for Better Health In Rural Texas

Formed in June, 1985, the Texas Rural Health Association (TRHA) goals are to promote rural health as a distinct concern in Texas, to serve as an advocate for rural health and to encourage the development of adequate health services in the rural areas of Texas. It was just the kind of organization that Brazos Electric Power Cooperative of Waco had been looking for.

"There were so many needs in the health arena, and too little time and money to make any kind of impact on an individual basis," says Jim Shannon, public relations representative for the generation and transmission cooperative, "We began looking for a statewide organization that we could support to go at this problem in the most effective way."

Once Shannon expressed an interest, the association put him right to work. He was named chairman of the legislative committee at the TRHA annual meeting in 1986. Under his leadership, the committee determined the priority issue to work on in the legislative arena—groundwater contamination. Statistics indicate that as many as one in five Texans are drinking water from private groundwater sources that are not monitored or regulated by any state agency for their potential health effects.

Through his groundwater safety work, Shannon built a network of contacts with health and agriculture organizations across the state, gaining their support for a bill that will come up for vote in 1989.

"Rural people rely on their electric cooperatives to take the lead in this kind of rural development effort"

If the bill passes, it will be another step down a long road of improving health conditions in rural Texas. Perhaps the next step will be to help provide licensed doctors and pharmacists for the ten rural counties that now have none—or a community hospital for one of the 43 counties in Texas that go without.

Meanwhile Shannon has been visiting with distribution cooperatives across the state to encourage more local cooperative membership in TRHA. "Rural people rely on their electric cooperatives to take the lead in this kind of rural development effort" says Shannon, "It's all part of improving the quality of rural life, and that's what we've always done best." ■

Water Line Will Promote Growth in Southern Indiana

A water line from the Ohio River in Jefferson County to Decatur County and then to Dearborn County would open the area to new industrial development. Steve Hilton, seated, coordinator of promotion and economic services for the Indiana statewide association of rural electric systems, discusses the project with (from left) Sharon Wilson, manager of area business development for Clark County REMC, and engineers John Caton, Grove Associates and Jim Frazzel, Triad Associates.

Sweat Equity Rebuilds Houses In Rural Wisconsin

In the summer of 1984, a tornado hit Barneveld, a town of 600 in south central Wisconsin. Nine people were killed, the business district was leveled and most of the houses were badly damaged or destroyed.

Rural Housing was among the organizations that helped the community secure a Farmers Home Administration (FmHA) grant for new "self-help" houses. Owners invested sweat equity—the husband and wife, supervised by a construction expert, each put in 20 hours a week to build their new house.

Rural Housing was born in 1970 as the Wisconsin Rural Housing Cooperative, an outgrowth of the statewide organization of rural electric co-ops, Wisconsin Electric Cooperative Association. It was formed in response to the co-ops' desire to help low-income rural people get decent housing. In 1983, it was reorganized into Rural Housing, but the rural electric connection is not broken. Leroy Rose, general manager of the Wisconsin statewide, is on the agency's board of directors.

According to Rural Housing, more than 58,000 rural Wisconsin families live in deficient housing, a figure that's on the rise, exacerbated by the farm crisis.

Rural Housing does not directly fund housing projects, but matches community funds with government sources of funding.

Barneveld has been rebuilt and the agency is starting a new self-help housing program in another nearby rural community. Also this year, it is getting home repair help for low-income people in rural Crawford and Vernon counties through a FmHA housing preservation grant.

To maintain effective advocacy work for low-income homeowners with limited staff and budget, Rural Housing has concentrated on networking with other organizations, such as the rural electric systems, to train communities to better use local resources to solve housing problems.

Rural Housing helps get housing programs started, and the communities run the program by themselves. It's the kind of sweat equity investment that pays off for rural America. ■

COMMUNITY LEADERSHIP

Discovering Local Assets

Since 1970, Fisher County, Texas has lost 750 of its 6,400 residents. The existing basis for the local economy, a gypsum wallboard plant and cotton farming, doesn't generate new jobs, so high school seniors pack up and go right after graduation. It's a version of a story that's repeated time and time again in rural communities across the country. After all, the living's not so easy if you can't find a job.

But this west Texas county isn't interested in sounding like another sad, old song. Two years ago, some of the leaders of Fisher County, including Parker Wetsel of Midwest Electric Co-op, decided it was time for a change of tune.

First, they formed an economic development commission and started looking at what there was to build on, who made things happen and who would help. When the commission contacted Steven Carriker, the majority whip of the Texas House of Representatives and Fisher County native, he helped bring in a resource team—people with economic development experience who could help get things started.

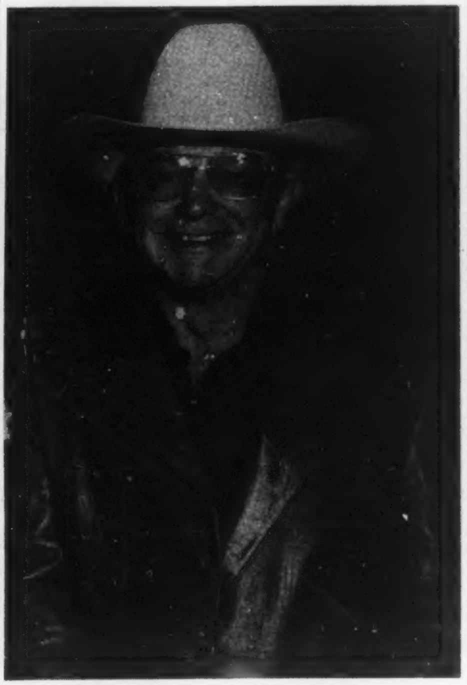
The team, including a representative from the National Rural Electric Cooperative Association, interviewed 130 Fisher County people to collect ideas on what might be done to produce more jobs. After sifting through the ideas, the resource team divided them into projects the community could tackle and projects that would require outside help. Among the community projects were constructing historical markers, applying for a grant for historic renovation of Main Street storefronts and expanding the county fairs and rodeos. Larger projects included developing a business "incubator," adding a livestock processing plant, and developing and marketing quail hunting.

Through this process, the county discovered it was already contributing to the community assets pool. For example, the county sponsors a doctor at the local hospital and is considering similar sponsorship of other professionals as a way of bringing its college-educated young people back home. A local banker and accountant had determined that 60 percent of the checks cashed in a year were for out-of-county purchases, prompting local merchants to find out why and work together to regain lost business.

Today the people of Fisher County see dollar signs when they look at their scraggly mesquite trees, their cotton burrs and cactus. The mesquite can be made into chips and sold to restaurants featuring mesquite-grilled steaks. The cotton burrs can be compacted into fireplace logs, and the cactus plants and other native foliage can be marketed to landscaping nurseries.

And perhaps the most ambitious idea is to turn Fisher County into a retirement area, to share the quality of life, the clean air and the sunshine with some new neighbors.

You may not find a better story of rural development in the making than the one in Fisher County. It's not particularly spectacular; that's the point. ■



Parker Wetsel, manager, Midwest Electric Co-op

Essential Services Unite in Missouri

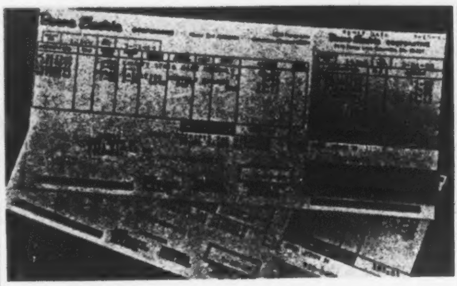
The organizations that provide fire protection, water and sewer services and electricity to rural Missouri turn out to have a lot in common. That's what Bob Alderson of Boone Electric Co-op and Frank Stork from the statewide, Association of Missouri Electric Co-ops, discovered as they pursued ways in which the organizations might join forces to better serve their common membership. Joint mailings, and in some cases joint billings, were among the possibilities that sprung to mind—both as a cost-saving factor for the organizations and as a convenience to their members. There would certainly be legislative issues of common concern and perhaps a common ground to fulfill financing and insurance needs. Out of these ideas the Rural Missouri Essential Services Association (RMESA) was born to formalize the concept and work toward common goals. It held its first annual meeting in the summer of 1987.

Through the Missouri statewide, the group is able to monitor legislation, tracking the bills of common concern and is actively engaged in building membership. Now at 123 consumer-controlled water, sewer, fire and electric systems, RMESA has its sights set on 400 members.

Boone Electric Co-op is serving as a model for progress at the local level. Already there's a new building on co-op property that serves as the headquarters for the sewer system, and, using the co-op's data processing services, both the sewer and electric bill go out together.

"Having all the essential services on one piece of property would be a tremendous convenience for new consumers," notes Alderson. "They could get all the necessary hook-ups accomplished without having to run all over the county."

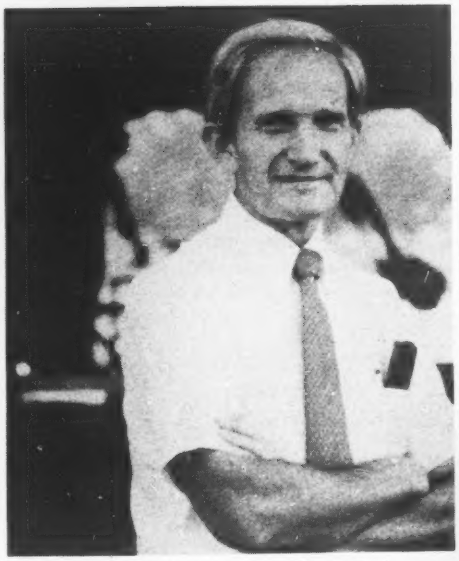
"It's a matter of doing what makes sense," says Stork. "It's the right thing to do." ■



The Other Side of the Mountain

In the late 1950s, the farm attrition had taken its toll on Jeffersonville, Vermont, a rural community on the other side of the mountain from Stowe, a ski resort community. Jeffersonville had a small, community-run ski lift, and to some people, was a more appealing place to be. Tom Watson, then president of IBM, was among the visitors who took a liking to the place and played a major role in developing Smuggler's Notch, as it is known today.

On the local front, Walter Cook, then manager of Vermont Electric Co-op, served on the local and state development boards and worked toward helping the area grow and prosper. Roland Vautour, presently USDA's Undersecretary for Small Community and Rural Development, served as the general manager for the ski village. The village was actually built around the ski lift. The co-op put in all underground service, and all the shops, which were locally-owned, expanded as the village grew. Since its development, Smuggler's Notch Skiways has been a training ground for Olympic medal winners as well as a retreat for less renowned fans of winter sports. Vautour recalls the effort as a prime example of a successful and visionary development project in which "the community leaders and the co-op's management were driving forces in developing the area." ■



Derl Hinson, recently named executive manager of Georgia Electric Membership Corporation, the statewide organization.

Beginning at the Beginning

National statistics belie the miseries of Noxubee County, Mississippi. Once a land of cotton farms and cattle ranches, the transition away from an agricultural economic base has been particularly painful. Population dropped, and there was a net loss of 1,000 jobs from 1960 to 1980. In the early 1980s, the unemployment rate was in the 20-percent range and half the population was below the poverty line.

A big barrier to change was attitude. The county was a collection of independent communities, divided by race, income level and location. On more than one occasion small industries that wanted to locate there were turned down by the people who had no economic incentive to invite change and little concern for those who did.

In 1985, Derl Hinson, then manager of Four County Electric Power Association, invited 40 community leaders together to talk about economic development. He explained that the co-op and the Tennessee Valley Authority (TVA) would give all the help they could, but the people would have to get the job done. "Without local people working at economic development, it won't happen," says Hinson.

The people responded to the challenge and agreed to form a county-wide development authority. The desire to change for the better was building.

At a public meeting held some two months later, 250 people gathered. Differences were put aside and the work was begun.

With the help of Four County and the TVA, Noxubee County has put together a development strategy that covers everything from industrial inventorying to fighting illiteracy to building roads and rural sewer systems. A storm window plant and a paper mill have since located in Noxubee County—and the work goes on.

"It has changed from an era of apathy to one of enthusiasm and cooperation with people working together in ways nobody ever dreamed possible," says Hinson. ■

OKLAHOMA RURAL ECONOMIC DEVELOPMENT MANUAL

OKLAHOMA ASSOCIATION of ELECTRIC COOPERATIVES

Providing Training in Economic Development

More and more, communities are making a formal assessment of their assets and taking a strategic approach to economic development. Often it's the co-op that shows them how.

In Oklahoma, the statewide association of electric cooperatives, in conjunction with Oklahoma State University, the RedArk Development Authority and the Verd-Ark-Ca Development Corporation has produced the "Oklahoma Economic Development Manual." The manual begins with an inventory of local services and facilities and takes the reader step-by-step through the economic development process.

The textbook was just the beginning. "Economic Development in Rural Oklahoma" was the topic of the seminar introducing the manual to member-cooperatives. With this special training and the economic development manual, the co-op managers now have valuable tools they can share with the communities they serve. ■

ATTRACTING INDUSTRY

Profile of a Professional

"You can't go it alone and be successful. You need a cooperative attitude."

That's the key to economic development according to Tom Monks, manager of economic development at Central Electric Power Cooperative, the generation and transmission co-op serving eight Missouri distribution systems.

Formerly on the staff of the Missouri Department of Economic Development, Monks brings a wealth of experience to the job. He's familiar with state agencies and has a depth of knowledge in state financing opportunities. He knows what's available. He's worked with the people of the University of Missouri extension services; he has called on the faculty of the engineering school there for help with design and engineering problems. He knows where to go for information.

Tom Monks, manager of economic development, Central Electric Power Cooperative

This is the kind of hands-on technical assistance he provides to industrial prospects.

But Monks is by no means a one-man band. Central has been a sponsor of the Missouri Community Betterment Program for many years and Monks works in a consultant role with this organization to help both the companies and the communities develop economic development projects. For example, a carbon production plant now under construction promises to employ 60 local people. It was the result of putting the idea man together with financing people, together with an individual with operations experience. Monks credits Bill Hayter, manager of industrial sales at Central and Gib Keith, director of economic development at N.W. Electric Power Cooperative, a neighboring G&T, and the member distribution cooperatives for the successes in the economic development arena.

He travels the service area of 26 counties and some 100 communities and works with the co-op managers on a daily basis. "I talk to the co-op managers more than I talk to my own boss," says Monks.

In process at Central is a data bank listing the financial resources, the elected officials of the area, existing industries and community profiles. Soon to be available to Central is the state's computerized information system, which covers everything from tax and finance to education and training programs offered through the state.

Rural economic development relies on people like Tom Monks, who continues to build and expand the resources available for the people he serves. ■

Tokico Construction Underway in Kentucky

Under construction near Berea, Kentucky, is the Tokico plant, which manufactures shock absorbers, and will employ 100 people. "The choice of this site was definitely driven by economics," says Blue Grass Rural Electric Cooperative Corporation Manager Jack S. Taylor, member of the development team. "The Tokico people wanted to know every detail. We had to be very well prepared." ■

A New Industry for Tabor, South Dakota

When Iowa businessman Karl Habena lost his golf bag manufacturing plant in a fire, he was determined to start over again, and fulfill a dream at the same time. Ever since he worked in southeastern South Dakota, he vowed to return, build a home on a lake and indulge in some hunting and fishing. He knew that it would be a good place to do business as well.

Habena settled in Tabor, South Dakota, a community of 460 that was founded on agribusiness and was feeling the effects of the crippled farm economy.

With a handful of employees, Coyote Sports began making golf bags again. Soon Habena's company was employing 17 people and providing extra income for families in a community where it was badly needed.

In 1981 Habena decided he was ready to retire. When a group of local businessmen, David Westbrock, general manager of Bon Homme-Yankton Electric Cooperative among them, caught wind of Habena's intentions, they tried to buy the business.

They knew Coyote Sports had become too important to the local economy to let it close. Though this purchase attempt didn't work out, Habena found an ideal team of buyers in Bob Wells and Larry Engle who had been working in the industry for a number of years. Both shared the dream of working on their own.

After Wells and Engle took over, Coyote Sports landed several major contracts and grew to employ 55 people. Among the original selling points were the quality of the workforce and the over-all business climate—factors that haven't changed according to Wells. "These people care about their work. They're reliable and give you an honest day's work. And the attitude of state and local government is extremely favorable towards business. I can't think of any negatives for doing business here."

The business recently expanded and now employs 67 people. Wells expects that the company will continue to hire additional people—big economic news for a town of 500, especially during tough economic times.

"We are very pleased to have a sound business like Coyote Sports in town," says Westbrock on behalf of the co-op. "They employ a lot of people who might have had to leave the community otherwise." ■

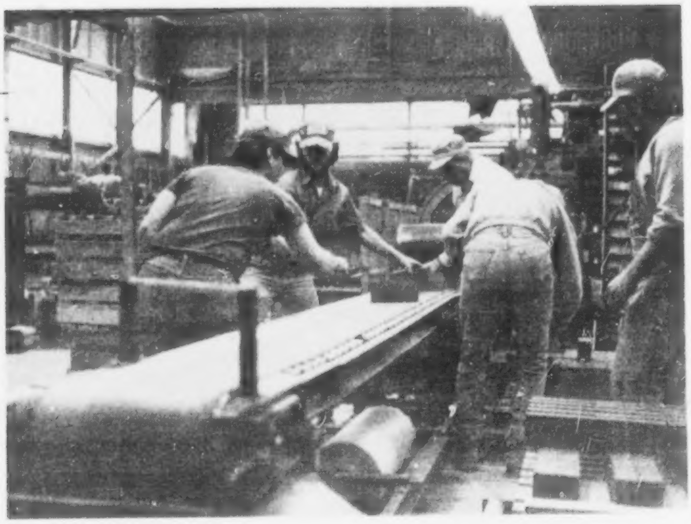
A Leader in Economic Development

One of the members of the electric cooperative network that has made extensive resource commitments to economic development is Olglethorpe Power Corporation, a generation and transmission co-op serving 30 distribution cooperatives in Georgia.

Over the past 12 years, Dave Morgan, vice president of economic development for Oglethorpe, has built a department of 25 professionals dedicated to encouraging industries to locate in rural Georgia. Through their computerized databanks, BuildingBank and SiteBank, they have the most extensive listing of industrial sites in the state.

"Tell us what services you need and we will provide you with the best information possible," Morgan tells industrial prospects.

This kind of technical assistance has led to 300 companies locating in their service area, creating economic opportunity for the citizens of rural Georgia. The Oglethorpe staff helps communities identify their needs and assets and develop strategies to make the fullest use of available resources. Their skills and technical expertise are offered freely and Oglethorpe stands as a leader in sharing its experience with others. ■



Creative Financing for Business

"We would not have been able to put it together without the help of the REC," says Dick McHose, a principal of the new LeHigh Clay Products company in LeHigh, Iowa. Beyond offering what McHose deemed "very competitive electric rates," Greene County REC put together a creative financing package that made the purchase of the plant possible.

Before it closed, the brick and tile plant had been the system's largest user of electricity over a twenty-year period. Because the plant was on co-op lines, it had been assigned patronage capital just like other co-op consumer-members. (Patronage capital represents the amounts by which a co-op's revenues exceed its expenses, amounts which are assigned to each consumer based on the consumer's contribution to revenues.)

The co-op agreed to make a loan to the buyers with the patronage capital—which had been assigned to the new owners as part of the purchase agreement—as collateral. This became the springboard for securing all other necessary financing. With the help of Craig Hamilton and Jack Bailey of the Iowa Area Development Group, comprised of four Iowa generation and transmission co-ops, the new owners were able to get financial assistance from the natural gas supplier, the Small Business Administration, as well as secure a state grant.

"The fact the co-op took the first chance, and that Craig and Jack would say 'it looks good to us' definitely made the difference in our getting the financial help we needed," says McHose.

In its first year LeHigh has already reached its two-year projected employment of 20 people. ■

A "Spec" Building in Iowa Expands Economic Base

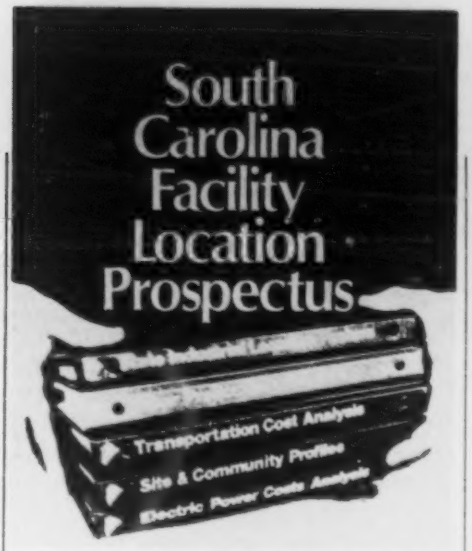
There are a dozen new "start-ups" on Main Street in Corning, Iowa—visible economic improvements despite several successive years of distressed farm economy. But Corning, population 1,900, has long been the kind of community that recognizes the need to diversify its economic base.

This diversification began in the early 1970s when the Blue Grass Industrial Park was just beginning to take shape. The idea was to build a 20,000 square-foot "spec" building to attract small industry. Adams County Co-op Electric anticipated the energy needs and relocated a planned substation to this site.

With these facilities in place and a lot of hard work on the part of the Adams Community Industrial Development Corporation, three industries moved into the park over the next decade. Today they provide more than 400 nonfarm jobs.

Dale (Bud) Wynn, Jr. serves on the board of the development corporation and is a director of Adams County Electric. He was among the community leaders who launched the fund-raising drive for a second "spec" building. The drive brought in more than $200,000.00 for the building fund, a tidy sum considering there are only 5,600 people in all of Adams County.

When an industry comes to Corning, it will continue to benefit from the community's local development efforts, all designed to help boost the economy and see to it that there's yet another start-up on Main Street. ■


South Carolina Facility Location Prospectus
Transportation Cost Analysis
Site & Community Profiles
Electric Power Costs Analysis

Economic Development Department Central Electric Power Cooperative, Inc

South Carolina's Award-Winning Efforts

The Industrial Development Research Council, which sets the standards for the industry, presented Central Electric Power Cooperative an award for the G&T's study of the South Carolina workforce as seen from the perspective of South Carolina manufacturers.

Because the state has so many labor-intensive industries, national figures on worker productivity just didn't tell the whole story. As part of its statewide development effort, Central got involved.

A 37-item questionnaire was sent to 1,200 plants in a random sample of the state's industries. The questionnaire covered all aspects of worker productivity, including labor relations and technical competence.

In an impressive 20-plus percent return, firms reported little or no difficulty in attracting applicants with appropriate education and skill levels for production jobs.

The study results have become part and parcel of Central's other marketing tools like the South Carolina Facility Location Prospectus, which provides a thorough presentation of the state's assets including a look at the many appealing lifestyle factors. Central also has an aggressive marketing program, advertising in four national industrial trade publications.

"Every new location is a team effort," says Fred Gassaway, Central's director of economic development, "and most of the successes have come about by the state or a community bringing us in as a team member to help solidify the project."

Central Power and its member cooperatives also offer an economic development rate as a further incentive to industrial prospects. "Economic development is very much a process that relies on the total available resources," Gassaway adds. "If co-ops can play a part, they benefit." ■

Joining Forces in Michigan

Northern lower Michigan has gained a great reputation as a vacation spot. The community takes pride in this image but wants others to know that the area is also ripe for other kinds of economic development. Promoting the area to industry is the job of North Force.

North Force, Inc. began in 1986 with 40 professionals with economic development interests, serving 30 counties in northern lower Michigan. Members include community growth alliances, public utilities, industry leaders and industrial development professionals who are dedicated to working with business and industry to provide technical assistance on financing, building and site location, employee training and area information.

Represented among the group are seven rural electric distribution cooperatives, the generation and transmission co-op and the statewide association which serves them.

"North Force is a team involving everyone from the private sector to local and state government. And we've begun our work by putting our available resources into action," says Ray Kuhl, executive vice president of Michigan Electric Cooperative Association, referring to the *North Force Magazine*.

Kuhl serves on the editorial advisory board for the magazine, which is circulated to some 10,000 businesses identified by North Force members as prospective commercial residents of the area. Consistent with the mission of promoting the area to potential businesses, Kuhl and other North Force members go where the prospects are.

"Because the area produces a wealth of fruits and vegetables, it makes sense to interest the food-processing industry in our area. To do so, we need to become active in selected industry trade shows and meetings," says Kuhl. "It's a pro-active approach to economic development." ■

A State Developer's Perspective

When you're in the trenches, you don't find many people shoveling the dirt," says Jim Stivers. He's a project coordinator for the Industrial Development Division of the Kentucky Commerce Cabinet and gets the electric co-ops involved early in a project. "I can count on them to be in constant contact at the local level and to help keep the ball rolling."

Sometimes it's a matter of providing constant encouragement—to give people hope and motivation as well as direction. A case in point is Wolfe County in eastern Kentucky, one of the lowest per capita income areas in the United States. This dubious distinction didn't stop the community leadership from pursuing Stivers' counsel, nor did it stop him or the co-ops he called on from digging in to help.

When invited to the county courthouse to speak on economic development, Stivers knew the G&T and the distribution co-op, East Kentucky Power Co-op and Licking Valley Rural Electric Cooperative Corporation in this case, would be there. "There must have been 90 people there," he said, amazed at the turnout for such a sparsely populated area.

"I didn't promise them a rose garden, by any means, but they do have a willing labor force and they're located near the mountain parkway. Above all, it will take tenacity and patience."

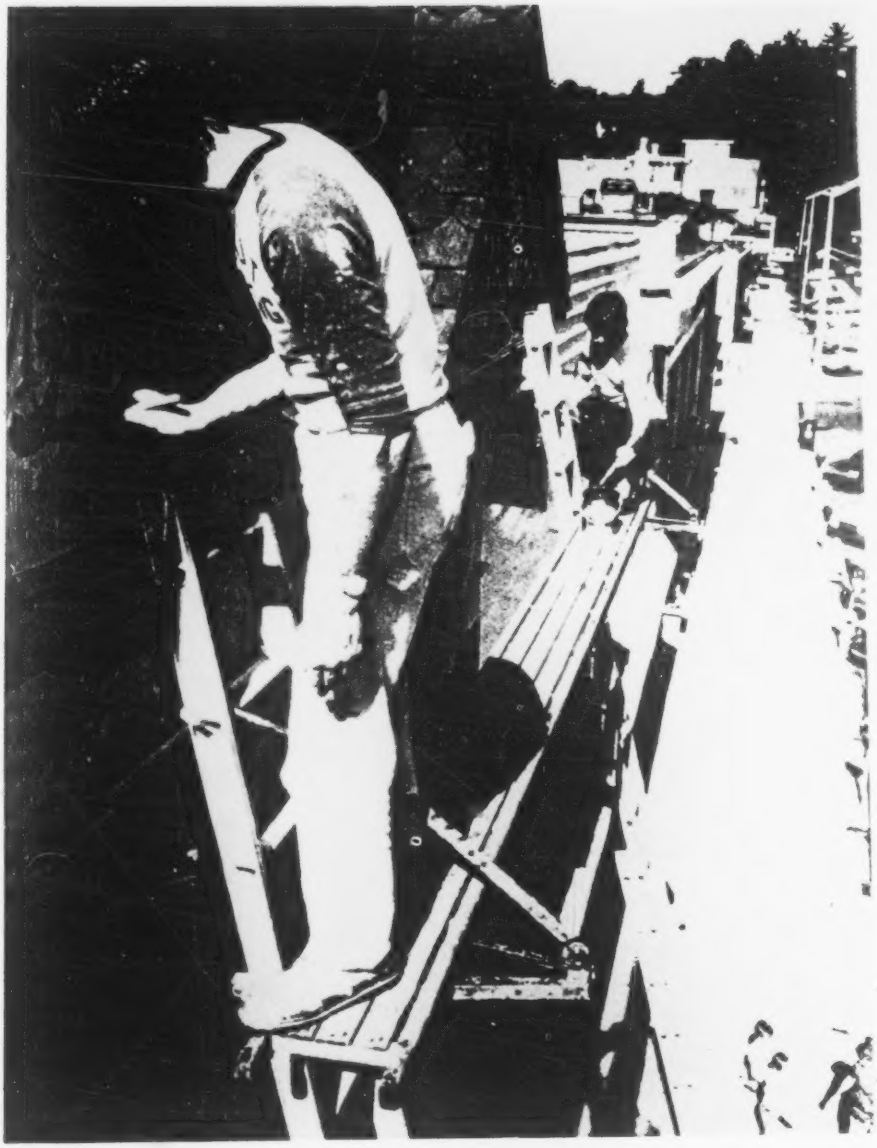
To date, the community has formed the Wolfe Industrial Development Association and hosted its first industrial prospect, a minority-owned government supplier eligible for a grant to operate in an economically deprived area.

So far it's moving right along. The owner conducted a demonstration for the community, training two people in a single afternoon to do the kind of work she needs.

"It's all networking and creative thinking, with a sharp eye open to reality. The co-ops are very much in touch with these concepts."

If successful, the company would become a nonprofit organization with 52 percent of the business owned by the community and a provision for the sale of the remaining 48 percent to the community in five years. It would become a revenue-generating source for the community to further economic development in the area, as well as providing the immediate benefit of as many as 100 much-needed jobs.

"There are still some vital details to work through, and I can't always go back as often as I'd like," says Stivers, "but I can rely on the co-ops to be there. They'll go beyond technical assistance in terms of electric rate offerings. It's all networking and creative thinking, with a sharp eye open to reality. The co-ops are very much in touch with these concepts." ■



HELPING LOCAL BUSINESS

Made in the USA

Steffes and Son Manufacturing Company, a family-owned job shop operating in Dickinson, North Dakota, has been characterized as being able to build anything out of nothing. It builds its own tools, does a great deal of custom work and has developed some products that can be mass produced, such as snow mobile skis, hopper bins and metal parts for office furniture. What was needed was another stable product that could be mass produced.

Meanwhile, Basin Electric Power Cooperative was in search of a domestic supplier of Electric Thermal Storage (ETS) heaters (essentially a home heating unit containing ceramic brick that can be electrically heated during off-peak hours). Basin had been working with the University of North Dakota to come up with a formula for the brick that would use local mineral resources instead of the imported material commonly used.

A combination of the efforts, skill and the resources of many to meet a need culminated in the expansion of the Steffes' business.

Research and development was supported by grants or loan guarantees from Basin Electric, the National Rural Electric Cooperative Association, the Western Area Power Administration and the North Dakota Energy Conservation Program.

Financing was arranged through a local bank, the Small Business Administration and the North Dakota Community Development Block Grant Program. All told, more than $1.2 million in loans and grants were put together to purchase the necessary facility and equipment and get Steffes' new ETS division started.

Just the development of the formula for the brick was a major undertaking. "We tested more than 100 formulas," says ETS coordinator Brian Fosaaen, referring to the work with the university. "It was a matter of trial and error, but just about the time we'd get discouraged, Bill Schott or Duane Bye from Basin would give us the push we needed."

The field testing for the heaters was a very important part of the project, too, and was accomplished through Basin's member distribution co-ops, which installed the heaters in single-family homes throughout their service areas.

A year and half later, Steffes ETS is producing 30 units a day, providing 35 new jobs in the community and putting a brand new American-made product on the market. Says Fosaaen: "Basin has been tremendous in support of our efforts." ■

". . .just about the time we'd get discouraged, Bill Schott or Duane Bye from Basin would give us the push we needed."

Tourism in West Tennessee

More and more tourists are now visiting Reelfoot Lake and local area businesses and residents are reaping the benefits.

Since 1981, people like Floyd Roberts of Gibson County Electric Membership Corporation and other community leaders have been working to help raise the standard of living for the depressed west Tennessee area. "We felt anything we could do to create employment opportunities would be worthwhile," says Roberts of the efforts.

They had a big asset in Reelfoot Lake, a natural lake covering 18,000 acres and adjacent to a state wildlife preserve. In fact, the area is said to be the greatest hunting and fishing preserve in the nation. Reelfoot Lake was once one of Tennessee's major tourist attractions, but the local ferry service across the Mississippi had long ago discontinued service, and a new bridge had routed potential tourists away from Tiptonville and the Reelfoot area.

The resurgence of Reelfoot became the focus as the local people put together their development strategies. They formed the Reelfoot Chamber of Commerce and the local interest mounted. The Tennessee Valley Authority (TVA) donated one of its surplus rock-hauling barges in an effort to help reopen the ferry service, and work began on bringing the barge up to passenger standards.

The restored home of native son and song composer Carl Perkins was put in place, and a museum was created for the man who wrote "Blue Suede Shoes" and many other famous songs.

A block of buildings was purchased by a local businesswoman, who developed a center housing the museum, a dress store, arts and crafts and souvenir shops.

Today there are restaurants, motels, picnic grounds, a 600-seat auditorium, cruise boat tours and campgrounds—all ready to serve the public. And there are a variety of new jobs from store clerks to fishing guides with 80 to 100 jobs estimated to come out of the revival of tourism in west Tennessee.

"It's a region that was too long forgotten," says Roberts, "and it's really gratifying to see Reelfoot back up and buzzing." ■

The Business Incubator

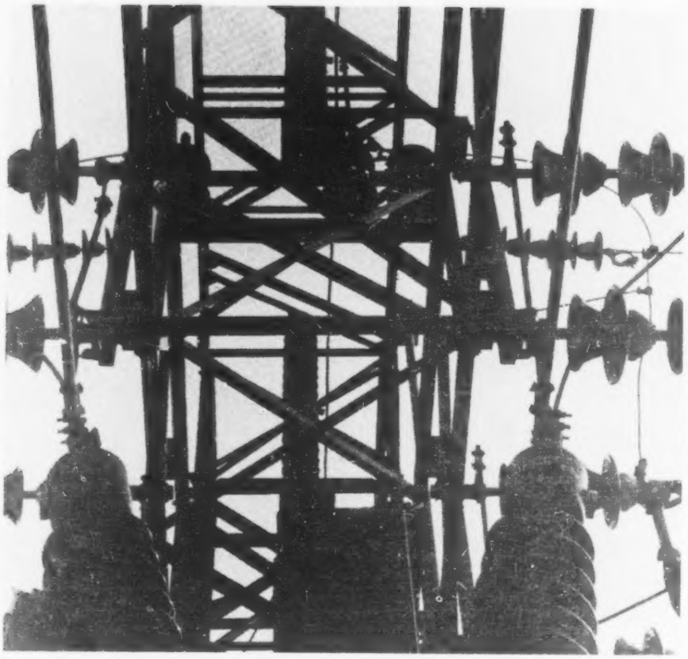
Another way to rural development is the business incubator. As the term implies, the business incubator provides a little help to get started—to help turn an avocation into a vocation and give new, small enterprises a place on Main Street.

Typically an incubator begins when an abandoned factory, school, warehouse or like building is renovated and converted into usable space for small business entrepreneurs. For a small fee, the incubator management provides support services such as building management, business advice, computer support, answering service and accounting. This permits the business person to concentrate on what he or she does best and greatly increases the prospect of success.

In Pennsylvania, a study funded by the National Rural Electric Cooperative Association through its member system Somerset Rural Electric Cooperative, determined the Somerset community to be a prime candidate for a business incubator. The plan is to purchase a 100-acre industrial site and construct a 20,000 square-foot incubator to house the new businesses, helping to give them a head start.

County Commissioner Brad Cober reflected the enthusiasm and hope of the Somerset community: "You're talking about a single site that will be developed into a full industrial site."

Already five businesses have expressed interest in using the incubator. ■



Many co-ops across the country have designed economic development rates to attract industry. When a co-op makes the fullest use of available power supplies, it delays the need for building or contracting for additional generating capacity. This helps keep rates stable for all ratepayers while it keeps the electric costs for potential industry competitive. ■

Economic Development Rate Approved in Indiana

Hoosier Energy Rural Electric Cooperative and Wabash Valley Power Association and their member distribution cooperatives have instituted an economic development rate, and the Indiana Utility Regulatory Commission, the state organization that regulates rates of utilities, approves. It issued a statement to that effect: "A review of the evidence of the petitioners and the public indicates an agreement that economic development rates can be beneficial to the utility's other rate payers and to the economy of the service area."

The rate is designed to produce revenues sufficient to cover the cost of serving the large consumer, and the commission observed, "no other customers would be subsidizing the lower rates."

The co-ops requested the special rate to help in their efforts to attract large industrial consumers, and, because attracting industry is such a highly competitive endeavor, the rate was designed to compete favorably with large industrial rates of other utilities in the region.

". . . economic development rates can be beneficial to the utility's other ratepayers and to the economy of the service area."

Among those testifying on behalf of the co-ops were local Chamber of Commerce officials and a representative from the Indiana Business Research Center in the School of Business at Indiana University.

BUSINESS AS USUAL

Electric co-ops across the countryside make significant contributions to their communities in an every day, business-as-usual way. It may be a matter of offering especially designed rates to help consumers manage electric use and save money or running a health fair at the annual meeting. It may be offering Red Cross first-aid classes, organizing a neighborhood watch, making meeting space available for community groups, offering clerical help and other assistance for community betterment projects, participating in career days at high schools or teaching youngsters about electric safety.

All of the co-ops put their organizational skill, their creativity and imagination to work for their consumers. Here are just a couple of samples. ■

Improving Paradise

Al Leece is smiling now. Everything's almost perfect in his retirement paradise in western Montana. Thanks to Ravalli County Electric Co-op and the National Rural Telecommunications Cooperative's (NRTC) new program package for satellite dish owners, television has come to Bitterroot Valley. There's not just the two channels Leece has learned to live with over the last eight years, but a choice just like his city friends have, of news, sports, four super stations, all three networks, public broadcasting stations and movies.

"I had more or less given up on television when I read a story in *Rural Montana* (the monthly magazine published by the state's rural electric co-ops) that outlined a new plan to develop a package of programs for people like me who depend on a backyard dish to get TV," recalls Leece. "I called and said, 'I'm coming in.'"

All Leece needed to do was give the co-op the number of his decoder and he received the NRTC program package that day. Today Leece is one of 8,000 subscribers to the NRTC package offered by 448 member-owned systems, mostly rural electric cooperatives. Millions of rural Americans live in areas too remote to ever have the benefits of good television reception and cable TV any other way.

Says Leece, "There's a feeling of isolation when you're cut off from news from the outside world. The co-op offers a service that no one else could."

The co-ops across the country are happy to offer this service and apparently so are the consumers as some 100 new subscribers are coming on line every day. ■

"The co-op offers a service that no one else could."

Al Leece
of Bitterroot Valley

Helping Consumers Help Themselves

Eugenia Jetton's work with financially troubled consumers of Gibson County EMC costs the west Tennessee co-op about $10,000.00 each year, but it realizes more than twice that amount from consumers whose debts might be written off without Jetton's intervention.

In fact, there's no price tag to match the kind of help she provides to consumers. She's a different kind of bill collector whose personal home visits to delinquent consumers in the nine-county area help get troubled people back on their feet.

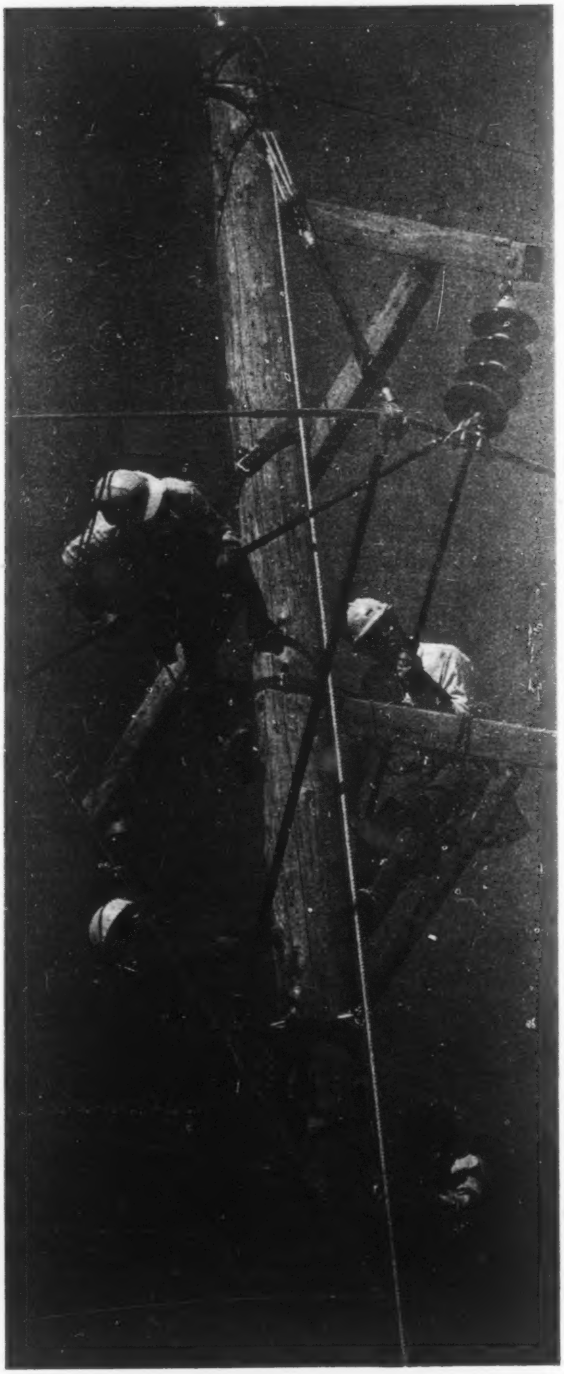
Jetton uncovers all kinds of problems by being a willing listener. She may learn of financial problems, broken marriages or health problems through her visits. Since she began this work in 1980, she's helped more than 1,500 consumers help themselves. Her referrals to social agencies, job placement and education programs have resulted in people getting the assistance they need.

In the course of her job, she's helped consumers get faulty appliances fixed, put plastic over their windows to keep the winter out and the bills down, and advised local emergency services of precise locations and needs of consumers on health support systems.

As chairman of the Gibson County Interagency Council, she compiled a directory of community service agencies that has helped eliminate duplication of services. Her work in community activities ultimately helps the people she serves through the co-op.

The attitude at Gibson is one of service to everyone. Some organizations look at slow payers as trouble. The co-op looks at them and says, "Is there some way to help them?" To do that it takes someone who really has a sincere concern for people, like Eugenia Jetton. ■

Eugenia Jetton, member services counselor, Gibson County EMC



The Art of the Possible

Demand is a word that we take seriously in the electric utility industry. It is the basis for the business. Yet for an organization owned and controlled by the people we serve, demand takes on a broader meaning. The people have come to know that the electric cooperative can do far more than provide electric power.

As an organization, we have a history of dealing with the "art of the possible." Was it possible in 1935 to bring electric light and power to rural Americans, 90 percent of whom were going without? Many, many thought "no—it can't be done." But through a partnership with government, and with the cooperation and participation of the people, the lights went on across the countryside, one household at a time. In that task alone, together we built more than a network of poles and power lines. We built a network of people whose leaders serve only as long and as well as they meet the demands of the people.

The demand for electricity has become essential, and another demand is emerging, developing with the same unanimity. A single voice from a chorus of millions cries for help to revitalize rural America.

Once again there are rumblings of "it can't be done." Once again, we know better. The pattern for progress is there and we are helping to rebuild what we can with the resources we have and the help of others—sometimes, just one job at a time. Just like providing electricity, revitalizing rural America is a tall order for an essential service to rural Americans.

We hear the demand.

We know it is possible.

We have the power.

National Rural Electric
Cooperative Association

1800 Massachusetts Avenue, N.W.
Washington, D.C. 20036

Senator BINGAMAN. Well, thank you very much.

There are several questions that have been prepared that I think we will just submit to each to you in writing, as appropriate. Since I did not hear the first two witnesses, I am not in a very good position to know what other questions may have already been raised. So let me go ahead and proceed to the third panel and dismiss this group.

Thank you very much for your testimony, and we will submit some additional questions to you.

Mr. LAROCHELLE. Thank you.

Senator BINGAMAN. Thank you.

The third panel consists of Bill Fulginiti of the New Mexico Municipal League and Mike Dunn of the National Farmers Union, and if they would come forward, please.

Bill, you look like you are it today.

Mr. FULGINITI. Thank you, Senator.

Senator BINGAMAN. The subject of this panel is infrastructure needs in rural America.

Why don't you go ahead with your testimony, Bill, and then I will see if there are questions I need to ask.

STATEMENT OF WILLIAM FULGINITI, EXECUTIVE DIRECTOR, NEW MEXICO MUNICIPAL LEAGUE

Mr. FULGINITI. Thank you, Mr. Chairman. Thank you for the opportunity to be here today to talk a little bit about rural infrastructure, at least as to how it affects us in New Mexico.

For the record I have submitted a prepared statement I think would be entered into the record. I would appreciate that.

Senator BINGAMAN. We will include that in the record.

Mr. FULGINITI. New Mexico is often described as a sparsely populated rural State, but, you know, it is interesting to note that of the approximately 1.3 million people who live in New Mexico, 800,000 of those people live in our five metropolitan areas. While that doesn't sound like a lot, what it does say to us is that being such a large State, we have 84 incorporated municipalities that are outside of the metropolitan areas in 30 of the 33 counties, spread across a very large geographical area and a variety of local economies.

In 1983, Lee Zink did a study for this particular committee for New Mexico, and in his study he defined infrastructure as roads and railroads and airports, water and sewer supply and distribution systems, and solid waste disposal.

What is notably absent from that is schools and universities and public office buildings, prisons, jails, and a variety of other kinds of infrastructures. That has not been addressed.

But even using that limited definition, Mr. Zink found there was $5.6 billion in capital needs between now and the year 2000 and only $4.2 billion of available revenues, leaving a gap of $1.4 billion.

Now, the deficiency in those numbers can be seen when you really look at what is left out. Municipal water supply needs were unknown. Solid waste management needs were unknown. Hazardous waste needs were unknown. Municipal roads, streets, and bridge needs were severely understated.

Since 1983, we have had an opportunity to do a different set of studies and we are able to estimate some additional costs for infrastructure in New Mexico in those areas.

Water supply construction alone will cost about $60 million by the year 2000.

Solid waste management, another $30 million by 2000.

Municipal streets and roads, $178 million by 1993.

Bridges are estimated between $100 and $200 million by the highway department, and that is just through 1993.

Public buildings—and that does not include jails—is estimated at $44 million and recreational areas about $16 million, all by 1993.

So an additional total of $350 million that was identified since Mr. Zink's study.

That $1.7 billion capital needs gap is a tremendous gap to recover in a small State like New Mexico. We think it is going to take a partnership of Federal, State, and local governments to do that.

In the study most recently done by the Engineering Research Institute of the University of New Mexico—Mr. Chairman, that is still, being compiled. Only 40 cities have responded—the most requested assistance in the area of infrastructure was not for the construction of infrastructure but for the operating and maintenance problems of those infrastructure programs, and that is overlooked so often when we talk about infrastructure.

In New Mexico cities, our small communities are spending close to half a billion dollars a year to operate infrastructure. That is a tremendous amount of money on limited tax bases.

One of the most recent surveys also asked the question, are cities and counties doing enough for themselves in the area of infrastructure? Are we always asking the Federal Government or the State government to pick up the tab?

I can tell you that outstanding debt has increased in cities from $192 million in 1983 to $875 million in 1988. That is a tremendous amount of increase in outstanding debt.

Besides that dramatic increase in debt service, there are other trends that we are able to pick up in the last 5 years.

Locally imposed taxes have grown more rapidly than any other source. In New Mexico locally imposed taxes have grown 31.5 percent, while the State-shared taxes, the State taxes, have only grown 17.7 percent.

The two areas of locally imposed taxes or fees that grew the most were our gross receipts tax, or what is commonly called sales tax, and charges for services, those fees that we do for our enterprise funds, grew over 60 percent in 5 years.

State and Federal grant sources have decreased by 58 percent in New Mexico, from a high of $227.6 million to $94.8 million, in just less than 5 years.

Our property tax that we used to fund a lot of these infrastructure programs received an increase in 1986 that was effective in 1987. To show you that local governments have had to step in and fill a breach, over 50 percent of those communities have enacted that new property tax.

Our gross receipts tax in cities, over one-half of all municipalities have used all of their tax resources. There are no more tax resources left for half of the 99 municipalities.

One of the other trends that we were able to spot is that of increased or new mandates given to municipalities by State and Federal Governments; for example, the new solid waste disposal regulations that are being considered in the State today, right to know requirements, hazardous waste disposal requirements, underground storage tank regulations, and that is just to name a few. But most of those are in the environmental area.

The impact of those regulations will be tremendous upon those small communities. In fact, I don't think they can be done. If we have to comply with those environmental regulations, what is going to happen is the investment we need for rural infrastructure will be eaten up by investments we need to make to fulfill these environmental regulations. I think we need to take a good look at that.

The past 5 years has also revealed another disturbing factor. The Federal Tax Reform Act of 1986 is clearly a move by the Federal Government to severely limit municipal tax-exempt bonds as well as an effort to tax municipal governments. We think that problem has to be addressed. If we are going to do infrastructure appropriately, we need the financing mechanisms to get there.

Some observations, if I may, Mr. Chairman.

Local governments have had to increase local taxes while the Federal Government has decreased taxes.

Local governments have had to increase local debt while the Federal Government has dismantled domestic grants.

Local governments have had to increase services and taxes because State and Federal Governments have increased mandates while not providing funding.

Local governments have limited tax sources and are rapidly approaching those limits.

Local governments have statutory as well as practical limits on debt and have increased their use of these sources until we are now approaching practical if not statutory limits.

In summary, Mr. Chairman, we have a couple of recommendations we would like you to consider, and while you are talking about parternship I think we should talk about some recommendations in all three areas.

Local governments should implement longer range planning for capital improvements. In New Mexico that is one of the things that we need to do more of. We have operated on short-term financing either through the Federal grant programs or through what is commonly referred to as the Christmas tree bill at the State legislature, where they come up and get their legislators to put in a special project, no long-term approach to capital improvements. We need to do that.

We need to utilize any existing revenue capacity where it is appropriate.

We need to better inform our citizens of the need for these capital improvements in our rural areas.

And we need to regionalize the appropriate infrastructure, such as landfills. We need to take a look at that.

The State government, on the other hand, has the responsibility of providing a diversified tax base to our local governments.

We need to remove restrictions on the Small Cities Assistance Act within the State government.

We need to remove restrictions on municipal investments. In New Mexico, by law, you can only invest your funds in certificates of deposit, and to me that is not where you should be at. It is too risky. We need to be in other instruments of investment that could earn more money and furnish more capital outlay programs.

We need to use the State Community Assistance Act, which is a grant program, grant and loan program, as the key infrastructure act because it centralizes things for one-stop shopping, so to speak, or one-stop prioritizing of our capital needs.

The problem with that program, Mr. Chairman, is the State hasn't funded it in 2 years. Zero dollars.

We need to increase the municipal share of gasoline tax for our road programs.

The Federal Government should, on the other hand, stop additional cuts in vital municipal programs, such as CDBG and UDAG, housing, some highway funding.

The Federal Government needs to stop eroding the Tax Code, specifically the tax-exempt status of our bonds. I have a couple of recommendations in that area.

The bond pool provision in H.R. 4333, which deals with a percentage of precommitment on behalf of cities, should be deleted from that bill. What it does is it forces bond pools in an artificial manner to precommit their funds in order to get the funds out to the cities, and what it does is it does not allow us any flexibility to grant loan programs under a bond pool provision.

The legislation introduced by Representative Donnelly, which conditions tax-exempt status of bonds on the amount of issuance costs, definitely should be opposed. We think that if you do not do that we will have a rush to the market by the end of the year. I think it contains a December effective date, and bond councils, knowing bond councils as conservative as they are, they are likely to advise their folks to get in before December just in case it happens to pass, and we can't afford that. That is not the way to control issuance costs. You control issuance costs with a number of other mechanisms, competition being one of them.

H.R. 3807, which was reported out yesterday unanimously, should be supported. This legislation changes the arbitrage threshold level on bonds from $5 million to $25 million, and that is appropriate. Right now a local government, if they are using their bonding capacity, if they go over $5 million they have an arbitrage problem. We think that is artificially low and should be raised to $25 million.

I think the Federal Government should assist municipalities which cannot be rated or insured for bonding purposes. You need to do that by establishing financing mechanisms that would perhaps either guarantee or buy these kinds of bonds.

Next, I think that you need to carefully examine the mandates given local governments, especially in the environmental field. Municipalities are now struggling with the implementation of regulations on those I have mentioned earlier—solid waste, right to know, underground storage tanks, et cetera.

Examine its role in the regulatory process and commit to being a full partner rather than being a regulator. Federal resources should be committed to assist local governments. It is just beyond local governments' ability to handle all of the infrastructure necessary under the environmental regulations.

In closing, Mr. Chairman, the immensity of providing infrastructure in our rural areas will require that full partnership.

I thank you for the opportunity to be here today.

[The prepared statement of Mr. Fulginiti follows:]

PREPARED STATEMENT OF WILLIAM FULGINITI

Mr. Chairman, Members of the Committee, I'm Bill Fulginiti, Executive Director of the New Mexico Municipal League. The League is an association of all incorporated municipalities in the State.

Thank you for the opportunity to discuss the rural infrastructure needs of our cities, towns, and villages.

New Mexico is a large state - the fifth largest in the Nation. The total population of New Mexico is slightly in excess of 1.3 million people. Two-thirds of those people live in incorporated municipalities.

While New Mexico is often described as a sparsely-populated, rural state, it is interesting to note that approximately 800,000 people live in the top five metropolitan areas. As you can see with so few metropolitan areas, New Mexico definitely faces the problems and challenges of financing infrastructure in rural areas.

Before addressing the issue of financing infrastructure, I'd like to bring you up-to-date on the magnitude of the need facing our municipalities.

In 1983 Dr. Lee Zink of the Institute for Applied Research Services, University of New Mexico, did a case study which was for the use of the Subcommittee on Economic Goals and Infrastructure Policy. In his study Dr. Zink defined infrastructure as:

> "...roads, railroad lines/crossings, airports, water/sewer supply and distribution systems, and solid waste disposal systems. This definition, used for purposes of this multistate study, omits many important facets of public infrastructure; e.g., prisons, jails, schools, universities and public office buildings."

Using this limited definition, this study was able to identify $5.6 billion in capital needs; $4.2 billion in revenues available and $1.4 billion as the capital needs gap.

The deficiency in these numbers can be expressed by the number of unknowns reported within the study's definition of infrastructure. Municipal water supply needs unknown. Solid waste management needs unknown. Hazardous waste unknown. Municipal road, street, and bridge needs severely understated.

Since this 1983 study, additional surveys have been completed and some of these unknowns can be estimated:

*Water supply construction - $60 million (yr. 2000)
*Solid waste management - $30 million (yr. 2000)
*Municipal streets and roads - $178 million (yr. 1993)
*Bridges - $100 - $200 million (yr. 1993 Highway Department)
*Public buildings - $44 million (yr. 1993)
*Recreation areas - $16 million (yr. 1993)

*TOTAL $350 million

Adding these figures to Dr. Zink's incomplete numbers ($1.4 billion + .35 billion) we now are looking at $1.75 billion in capital needs gap. That's a tremendous amount for such a sparsely populated state.

More revealing is a 1988 survey being conducted by the Engineering Research Institute of the University of New Mexico and I quote:

> "The most requested assistance was for operation and maintenance for nearly every category of infrastructure. This was followed by the need for clarification of regulations that affect communities concerning water, wastewater, solid waste and hazardous waste."

Operation and maintenance assistance - to put that request into focus and to understand the reason for the request, you need to know that New Mexico cities expend approximately $400 million annually, operating and maintaining infrastructure.

One of the most asked questions is, are cities utilizing their own resources as much as possible? The answer is two-fold. Cities have picked up the slack where States and the Federal government have withdrawn. Cities in New Mexico have increased their outstanding debt from $192,353,419 in 1983 to $874,383,694 in 1988. The largest increase occurred in revenue bonds ($41 million to $875 million).

Besides that dramatic use in debt service of municipalities, several other trends were noted that affect infrastructure financing.

*Locally-imposed taxes have grown more rapidly than other sources. That is evidenced by the statistic: Locally-imposed - 31.5% and State-shared - %17.7%.

*The two areas of locally-imposed taxes or fees that grew the most were: (1) Municipal Gross Receipts Taxes - 41% and (2) Charges for Services - 60.3%

*State and Federal grant sources have decreased by 58% ($227.6 million to $94.8 million)

*Municipalities are approaching their limits to acquire additional revenues.

- Property Tax - 31 municipalities used new authority with 50% (15) of those going to max. 7.650.

- MGRT - over 1/2 of all municipalities have enacted all local option gross receipts taxes and over 2/3 have enacted at least 1%.

*Another discernable trend is that of increased or new mandates given to municipalities by the state and Federal governments. For example new solid waste disposal regulations, right-to-know requirements, hazardous waste disposal, and underground storage tank regulations to name just a few.

*The past five years have also revealed another disturbing factor. The Federal Tax Reform Act of 1986 is clearly a move by the Federal government to severely limit municipal tax exempt bonds as well as an effort to tax municipal governments. The Federal government is also moving to pre-empt state and local tax sources, especially in the area of gasoline tax where a 15 cent increase is under consideration.

OBSERVATIONS

The statistics published by the Local Government Division of the Department of Finance and Administration are used here to support some of the feelings generalized over the past few years.

(1) Local governments have had to increase local taxes while the federal government decreased taxes.

(2) Local governments have had to increase local debt while the federal government has dismantled domestic grants.

(3) Local governments have had to increase services and taxes because the state and Federal governments have increased mandates while not providing funding.

(4) Local governments have limited tax sources and are rapidly approaching those limits.

(5) Local governments have statutory as well as practical limits on debt and have increased their use of these sources until we are now approaching practical if not statutory limits.

RECOMMENDATIONS

Given these trends and observations the League believes the following recommendations are necessary:

Local Government Should:

(1) Implement longer range planning for capital improvements.

(2) Utilize existing revenue capacity where appropriate.

(3) Inform their citizens of the need for capital improvements.

(4) Regionalize the appropriate infrastructure such as landfills.

State Government Should:

(1) Provide municipalities with a Diversified Tax Base-legislation should be enacted to allow a municipality to take advantage of differences in local economies:

a. Maintain existing Gross Receipts Taxes.
b. Retain authority to impose property tax millage.
c. Grant authority to levy a local option municipal income tax, or share in the state income tax.

(2) Remove the restrictions on the Small Cities Assistance Act in order to provide for municipalities with inadequate tax bases.

(3) Remove the restrictions on municipal investments and allow additional investment instruments.

(4) Establish permanent fund for infrastructure including streets and roads, Highway Cooperative Program, Municipal Arterial Program, Wastewater Treatment Facilities, and Rural Infrastructure Program.

(5) Use the State Community Assistance Act as the key infrastructure program within the State.

(6) Increase the Municipal Share of the Gasoline Tax.

(7) Return the Special Gross Receipts Tax for infrastructure and amend to:

a. allow bonding,
b. clarify repair and replacement definition; and
c. allow new capital outlay projects.

Federal Government Should:

(1) Stop additional cuts in vital municipal programs, e.g. CDBG, UDAG, Housing, Highway Funding, and Mass Transit.

(2) Stop eroding the Tax code, specifically the tax exempt status.

a. The Bond Pool Provision in HR 4333 which deals with a percentage of pre-commitment on behalf of cities should be deleted.

b. The legislation introduced by Representative Brian Donnelly which conditions the tax exempt status of bonds on the amount of issuance costs should be opposed.

c. HR 3807 which is scheduled for mark-up Thursday should be supported. This legislation changes the arbitrage threshold level on bonds from $5,000,000 to $25,000,000.

d. Assist municipalities which cannot be rated or insured for bonding purposes by establishing a financing mechanism that would buy these bonds.

(3) Carefully examine the mandates given local governments, especially in the environmental field. Municipalities are now struggling with the implementation of regulation on Solid Waste Management, Right-to-Know, Underground Storage Tanks, Hazardous Waste Management, to name a few.

(4) Examine its role in the regulatory process and commit to being a full partner rather than a regulator. Federal resources should be committed to assist local government.

In closing, the immensity of providing infrastructure will require a full partnership between federal, state, and local governments.

Thank you.

Senator **Bingaman**. Thank you very much.

Before I ask any questions, let me call on our final witness, Mike Dunn, who is the legislative director for the National Farmers Union. We are glad to have you here.

STATEMENT OF MICHAEL V. DUNN, DIRECTOR OF LEGISLATIVE SERVICES, NATIONAL FARMERS UNION

Mr. **Dunn**. Thank you, Mr. Chairman. It is a pleasure to be here today on behalf of the National Farmers Union and the almost 250,000 family farmers that we represent. We commend the Joint Economic Committee and the Congressional Research Service for having these hearings and sponsoring the symposiums that are going to be taking place in the next few days.

A variety of interesting approaches are being proposed in some bills that have already been introduced in the House and the Senate, and it is not surprising that there is live interest once again in rural development. The 2,400 rural counties of the Nation lost one and a quarter million residents in 1986 and 1987.

In our prepared statement we are submitting for the hearing record, we examine the rural economic base and infrastructure.

The approach to the subject is essential because we must know what is there to build on in rural America before intelligent and productive measures can be conceived and carried out.

Rural America is diverse and varied in its economic makeup. Within States and from State to State, the mix of industries differs greatly. Nonetheless, some foundation industries emerged in the situation as we studied it.

Agriculture is clearly the backbone industry in the 2,400 rural counties. It provides 15 percent of the income in rural America as a whole and one-third of the income in the 700 major agricultural counties.

Mining and energy production account for 5 percent of the income in rural America as a whole, but 36 percent of the income in the 200 counties involved in such production.

When we combine the agricultural and the energy and mining activities, we see that they generate 20 percent of the income of rural America and 40 percent of the income of the 900 producing counties. While these activities involve only 10 percent of the rural population, they account for fully 40 percent of the economic base in those 900 counties.

Our prepared statement also examines the constraints which lack of infrastructure impose on our growth prospects. Unfortunately, traditional rural development strategies do not address themselves to problems involving infrastructure.

In the National Farmers Union we have found that there are severe problems relating to substandard roads, unsafe bridges, deteriorating rail services, inadequate but costly trucking and waterway transportation.

The task of providing rural electric and telephone services is far from complete. Rural America needs improvements in its access to radio and television broadcast services and to availability of communications networks and satellite services.

These needs often may have to be addressed in major legislation apart from strictly rural development measures. We feel that an omnibus approach to rural development is preferable.

As you will note in the data provided in our prepared statement, it has been the poor performance in the farm and energy sectors that has principally caused the economic stress which has been so widespread from 1986 to the present.

This has led some rural development specialists to conclude that agricultural is no longer an effective means of enhancing rural income and purchasing power. Such a judgment is faulty. It fails to recognize what actually happened. The rural economy suffered because price and income support measures were reduced. Had farm programs been maintained at the 1980 level or higher, the depopulation of rural areas need not have happened.

The National Farmers Union does not contend that farm policy is the only remedy needed. We only contend that it is the quickest way to revive America's countryside.

We agree that diversification of employment opportunity is definitely needed in rural regions. However, we visualize that the creation of service, communications, and professional job opportunities will take much time and substantial investment, perhaps 10 to 15 years and as much as several billion dollars in loans or loan guarantee programs.

Meanwhile, these beginning efforts to create nonfarm jobs will have to compete with further declines in the farming and oil-patch sectors.

The provisions of the Food Security Act of 1985, which will apply in 1989 and 1990, will cause further declines of several billions of dollars in the farm economy.

On the other hand, just to return to price and income support levels of 1980 would pump $10 million of added income into agriculture and rural America. This would dwarf any gains which could be achieved soon by conventional rural development stratagems.

We freely acknowledge in the National Farmers Union that farmers do not function in a vacuum. Farming has always been linked to the community and to the larger economy. Agriculture is not insulated against weaknesses in the national economy.

At the same time, the national economy cannot be vibrant and healthy over the long term if agriculture and other foundation industries are chronically sick.

We recognize the most devastating declines in farm income in 1932, 1955, 1975, and 1981, and from 1966 to 1988 can be attributed as much to weak demand as to farm overproduction.

It is no coincidence that the last time American farmers enjoyed full adequate prices and income was also the last time full employment prevailed in the Nation. That year was 1952, 36 years ago.

Finally, we wish to direct your attention to the data on farm and rural poverty which appears in our prepared statement.

In 1959, when poverty rates were first calculated, the rate for farmers was a stunning 45 percent. Great progress in relieving farm poverty was achieved in the 1960's. By 1973, the farm poverty rate was down to 13.4 percent.

Then, as the farm programs were scaled down, farm poverty began to creep upward again. By 1979, it was up to 17.7 percent; by

1983, 23.7 percent. Today, it is estimated at 25 percent, with hired farm workers at 31 percent.

We feel that the charts and the presentations that were given here today indicate that we have a dwindling amount of human, natural, and fiscal resources to achieve the goals of rural development.

We in the National Farmers Union feel that this is an excellent opportunity to look at the record, look at what is needed, and in 1989 put forth with a new administration an omnibus rural development bill that will bring to bear all the Federal, State, and local human and fiscal resources to once again give the rural population in America an opportunity to be a part of the recovery that the rest of the Nation seems to have had.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Dunn follows:]

PREPARED STATEMENT OF MICHAEL V. DUNN

THE RURAL ECONOMIC BASE AND INFRASTRUCTURE

From 1930 to 1970, Rural America saw an outmigration of about 30 million persons. In the 1970's, however, the rural population growth rate outpaced that of metropolitan areas by a margin of 15.7% to 9.9%.

That reversal of earlier loss of population on the part of rural sectors proved to be only temporary.

Federal policies in the 1980's, which reduced the value of output in the natural resource-based industries, such as agriculture and energy, accounted in part for the depopulation of the areas where this production was substantial.

National Farmers Union recognized these trends and advocated both farm and off-farm rural remedies.

In recent years, members of the Farmers Union have objected to the export of farm products from their communities at less than the real cost of production. Specific recommendations were offered for the strengthening of price and income support levels under the 1981 and 1985 Agricultural Acts but were not accepted.

At the same time, Farmers Union proposed the creation of a separate RURAL DEVELOPMENT ADMINISTRATION to handle economic diversification efforts in the rural sector.

DIVERSITY IN RURAL AMERICA

Rural America is diverse. The natural resource industries are not evenly spread throughout countryside America.

Agriculture is by far the most important industry in terms of income-production in the 2,400 nonmetro counties. It accounts for 15% of the income in these counties and for 33% of the income in the 700 major agricultural counties.

Energy and mineral extraction account for 5% of the income of the nonmetro counties but for 36% of the income in 200 major mining and energy-producing areas.

In all areas, farming and mining/energy combine to account for 20% of the income of all nonmetro counties and 40% of the income where natural resource activities are substantial. This is true even though the farm populations is only 9% of the total rural head-count and farmers and farm workers are only 8% of the rural workforce.

Prior to 1977, increases in price and income support levels could be counted upon to increase the value of farm output and the creation of community wealth.

CAUSE OF THE RURAL INCOME DECLINE

With the departure from supply management agricultural programs and the reduction of price and income support levels, rural income was destined to decline. This trend was accelerated in the 1981 and 1985 Acts.It was the poor performance in the farm and mining/energy sectors that principally caused the economic stress which was so widespread in 1986-88. More than 1,000 rural counties had unemployment rates of 9% or more and the mining/energy sectors had even larger jobless rates.

This led some to conclude that agricultural policy was no longer an effective means of enhancing rural income and purchasing power. They reasoned that the rural economy is no longer isolated from the national and global economies. The next step was for some rural development specialists to conclude that they must focus entirely on industries other than those based on natural resources.

Farmers Union does not dismiss the value of developing diversity of employment opportunities in the rural communities. There have never been enough off-farm jobs to hold farm youth within the local community or region.

However, the development of service, communications and professional job opportunities will take much time and substantial investment --- perhaps as much as 10 to 15 years.

Meanwhile, such jobs which may be created through rural diversification activities will probably be outnumbered by several times by the job losses through further deterioration in the farm and mining/energy sectors.

FURTHER FARM INCOME REDUCTIONS ARE SCHEDULED

The built-in reductions in farm prices and income under the 1985 Act will ensure the further decline of the agricultural production sector in 1989 and 1990. CCC crop loan levels are due to drop by 5% and target prices by 2% a year and the Executive Branch wants an even faster reduction.

Unless some quick and dramatic action can be taken, the rural decline will have so changed the rural fabric that it will be abandoned as the living space of the future.

This is not to say that Rural America has no long-term future.

Both agriculture and energy can have a future. Mining's future will depend upon whether reserves of ore or coal have been depleted and whether there will be a price policy which will enable producers to recover costs.

Energy's future will depend upon whether the nation eventually develops an energy policy. Fossil fuel reserves will last another 40 to 50 years. In the intervening years, renewable fuels, nuclear energy and solar energy can develop to fill the needs. But none of this will happen if the producers cannot recover their operating costs.

THE QUICKEST SPUR

Agriculture can be the source of the quickest and greatest spur to the rural economy.

U.S. net farm income for 1988 may be as low as $38 billion. If farm prices were at levels which assured an average cost of production return, net farm income would be in the range of $75 to $80 billions.

An infusion of an added $40 billion a year into the farm economy would put farmers and ranchers into a profitable position, revitalize Rural America's main streets, create 1 to 2 million jobs, stimulate farm outlays for capital items (equipment, housing and livestock), and strengthen and stabilize the rural tax base for schools, public services and rural infrastructure. Profitability on the farm would cause the difficulties of the country banks and the Farm Credit System to disappear.

Of course, a $40 billion gain in farm income would not occur overnight. It would likely be phased-in in steps.

Certainly, an income gain of $10 billion a year is attainable and achievable. Such a gain would completely dwarf any employment and income gains possible through economic diversification --- through the conventional rural development stratagems.

A simple return to 1980 levels of farm prices and purchasing power would assure an income gain of more than $10 billion a year in net income.

In fact, the agricultural recovery may have to come first in order to stimulate investment in other enterprises.

If there is any concern that a $10 billion or $40 billion income improvement in agriculture would spur inflation or injure consumers, the experience of the period from 1940 through 1952 should be reassuring. That period of 13 years saw farm prices continuously at or above 100% of parity. In that period:

+ The inflation rate averaged only 2.79%.
+ Retail food costs advanced only an average of 3.50% a year.
+ The prime rate stayed continuously under 1%.
+ Unemployment averaged 3.1% of the labor force.

AGRICULTURE'S LINKAGES

Agriculture does not function in a vacuum. It has always been linked to the community and to the larger economy. The agricultural economy is not insulated against whatever weakness there may be in the national economy.

The agricultural lexicon of the past half century has been replete with cries of "burdensome surpluses," yet the cause of farm trouble has been as much attributable to weak demand as to sheer overproduction.

The most devastating declines in farm prices and income, 1932, 1955, 1975, 1981 and 1986-88, occurred when weak demand clearly was a major factor.

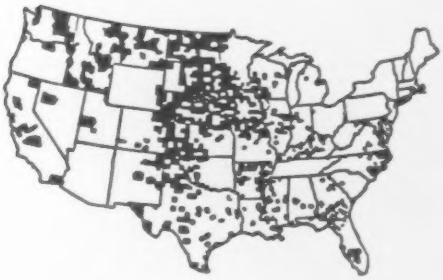
It is no coincidence that the last time American farmers enjoyed full parity prices and income was also the last time that full employment prevailed in America --- that was in 1952.

If world economic growth rates were stronger than the current 2 to 3% rates, effective demand for farm products would improve appreciably to the benefit of producers in both Third World and industrial nations.

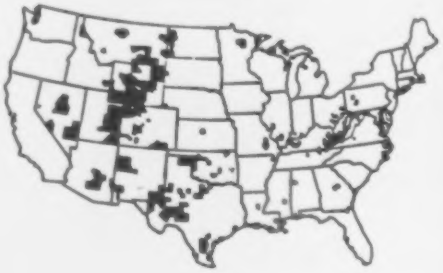
Farming is carried on in 3,000 of the 3,137 counties in the nation. In 700 counties, it accounts for 20% or more of the total income, with an average of 33%. In some counties in the mid-lands, as much as 60% of the income is derived from farming.

There are about 200 counties in which mining is important, where it accounts for an average of 35% of the income. These tend to be different counties than those with strong agricultural income. In these 200 mining counties, agriculture accounts for less than 7% of the income.

Farming-Dependent Counties

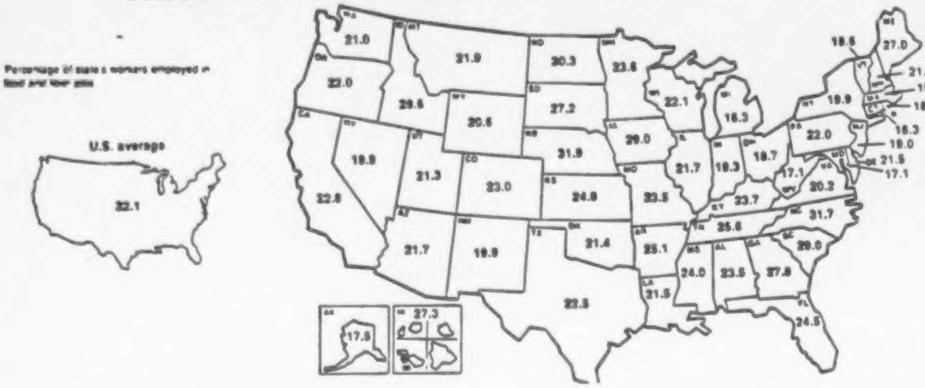


Mining-Dependent Counties



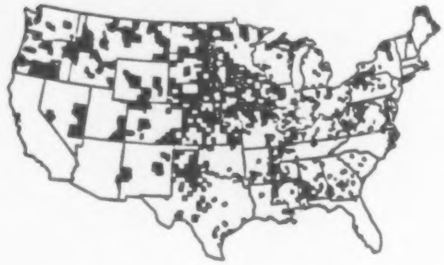
Another measurement of the relative importance of agriculture in the community, region and the national economy is that of the 110 million gainfully employed, about 20% earn their living in farming or agribusiness. The extent to which jobs are related farming and agribusiness are shown in the accompanying map:

PROPORTION OF LABOR FORCE EMPLOYED IN FOOD-RELATED JOBS

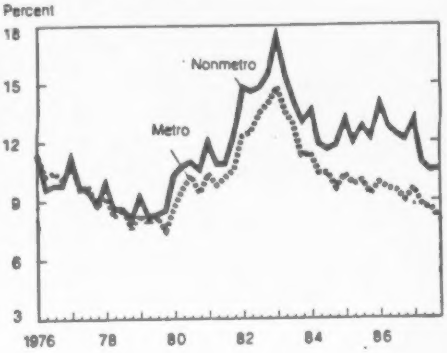

Percentage of state's workers employed in food and fiber jobs
U.S. average
22.1
21.0
22.0
22.8
19.9
28.5
21.9
20.6
21.3
23.0
21.7
19.9
30.3
27.2
31.9
24.8
21.4
22.5
23.6
29.0
23.5
25.1
21.5
22.1
21.7
18.3
19.3
18.7
23.7
25.6
24.0
23.5
27.8
24.5
29.0
31.7
20.2
17.1
22.0
19.9
18.6
27.0
21.0
19.8
18.5
18.3
19.0
21.5
17.1
17.5
27.3

Other disturbing elements in the rural picture are the loss of population since 1980 (shown below) and the relatively higher unemployment rate in rural counties as compared with metro communities (also shown below.)

Nonmetro Counties with Population Decline, 1980-86



Unemployment Rates for Metro and Nonmetro Areas



RISING INCIDENCE OF POVERTY ON FARMS, IN RURAL REGIONS

Despite several billions a year in federal farm payments and substantial off-farm earnings by residential and part-time farmers, the number of farm people and rural people living below the poverty guidelines has been increasing since 1979.

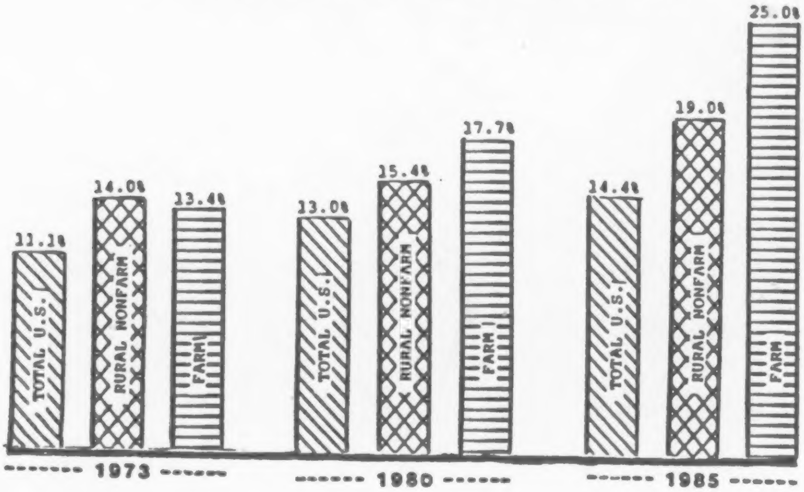
In our society as a whole, over 33 million people are living in poverty, more than 13% of the total population.

- When poverty rates were first calculated in 1959, the rate for farmers was a stunning 45%. Great progress was made in the 1960's and the farm poverty rate was just barely over 20% at the end of the 1960's. Relative prosperity on the farms in the early 1970's pulled down the farm poverty rate down to 13.4% in 1973.

Then, as the farm programs are scaled back, farm poverty began to creep upward again. By 1979, the farm poverty rate was 17.7%. It rose to 23.7% in 1983 and is now estimated at 25%. The poverty rate for rural nonfarm people is estimated at 19% and for hired farm workers at 31%.

The decline in the farm and rural economies was directly attributable to the reduction in farm price and income support levels in the 1977, 1981 and 1985 Agricultural Acts.

POVERTY RATES, 1973, 1980, 1985



RURAL INFRASTRUCTURE

Limitations of the physical infrastructure in Rural America present some definite constraints on economic growth.

These problems often are not addressed in traditional approaches to rural development programs.

In Farmers Union, we recognize that these problems, which relate to roads and bridges. rail, waterway and truck transportation, public hospitals and health facilities, rural electrification and rural telephone services, radio and television broadcasting, communications networks and satellite communications, may need to be addressed in legislative contexts apart from rural development measures.

Farmers Union considers the family farm structure the keystone of a viable agricultural system. Infrastructure is essential in order for the family-scale farms to functio optimally.

The 1988 Farmers Union policy statement expresses its concern for "care of land and water resources, rural development and quality of life in rural communities."

The policy statement calls for "federal, state and local support for an integrated transportation system to serve America's farmers and other rural residents."

The Farmers Union expresses concern that rail deregulation is eliminating service to some communities and allowing the exploitation of some shippers who have no alternate means of service.

In regard to trucking service, Farmers Union recommends that regulation should focus on reliable service and fair rates.

Farmers Union proposes that bottlenecks on the orderly movement of farm commodities on barges on the inland waterways should be taken care of by the federal government without undue imposition of the costs upon shippers of bulk commodities, such as grain, fertilizer and fuel.

The Farmers Union policy statement declares that the role of the federal government "in assisting consumer-owned, non-profit rural electric and telephone cooperatives to provide reliable and affordable service in rural areas is by no means complete."

The economic outlook for community-based services is clouded by the effort of the Executive Branch to eliminate funding for the Rural Development agency, the Economic Development Administration, the Appalachian Regional Commission, and the Small Business Administration, and by other recommendations to slash funding for infrastructure and for highway assistance to state and local governments.

ENERGY INDEPENDENCE, A FADING GOAL

America is losing ground in its goal of attaining energy independence. We are now importing half of our crude oil needs. Our imports of refined products have doubled since 1982 and some domestic refineries have shut down.Much of the decline has been among small and medium-sized operations which have always accounted for a large share of national output.

Meanwhile, low crude oil prices (with the world price at about $15 a barrel) are discouraging domestic exploration and production. Stripper wells are being capped, not when they run dry, but when they become unprofitable. Hundreds of drilling rigs have been taken out of operation.

The United States is less prepared for an interruption in crude oil supplies than it was in 1973 or 1979. We no longer have any standby system of allocations or priorities to assure supplies to essential services such as fire and police services, hospitals, or food production and distribution.

The U.S. has no national energy policy. The White House believes that everything should be left to the chance of the market-place. The Strategic Petroleum Reserve is only partially filled.

The Middle East oil embargo in 1973 shut off only 3 million barrels a day but caused a tripling of oil prices. The Iranian crisis in 1979 cut off 2 million barrels a day, again with a tripling of prices. A total stoppage of oil traffic from the Persian Gulf would shut off 6 million barrels a day and send oil prices to $100 a barrel. The U.S.is totally unprepared for such a calamity.

Senator BINGAMAN. Thank you very much.

One of the items that you brought up, Mr. Fulginiti, was this possibility of a financing mechanism in order to purchase bonds from small communities that are not able to obtain any kind of credit rating.

Could you elaborate on that?

That is something which, as I have traveled New Mexico, I have found a lot of small communities that really don't seem to have any kind of capability to obtain financing for some of their local infrastructure needs, and I am interested in knowing anything else you could say about how that might function.

Mr. FULGINITI. Thank you, Mr. Chairman. We have also noticed that problem as we traveled New Mexico.

I believe the Budget Office is going to release a report in the near future on perhaps a secondary market that would do that.

You can do that in a number of ways, Mr. Chairman. You can do it by a set-aside of a capital fund that would guarantee those bond issues or just direct purchase out of that capital fund.

Two other mechanisms could be used, and one would be just pledging the full faith and credit, and that would also guarantee an insurable bond rating, which would save perhaps between 75 basis points and perhaps a full percentage in a bond issue.

I don't have the exact details for those proposals, Mr. Chairman, but I will be able to go back and give those to you. I just know that is one mechanism that the State is looking at, and I think the Federal Government is also, and ought to be considered as a way of saving money and building infrastructure.

Senator BINGAMAN. Any more detail you could give me on those proposals I would be anxious to hear about.

Mr. Dunn, did you have any comment on this type of a proposal, whether you think it is meritorious?

Mr. DUNN. Mr. Chairman, I believe that Senator Moynihan's committee reported out a bill that did a similar type of thing, which would allocate a certain amount of resources to an individual State, and then they could set up sort of a revolving fund that the individual communities could utilize, and that would appear to be an excellent method to approach that problem.

Senator BINGAMAN. OK.

I appreciate very much the testimony. I think it has been excellent, and we may have some additional questions we will submit to you in writing. But I thank you both for being here.

Mr. FULGINITI. Thank you, Mr. Chairman.

Mr. DUNN. Thank you, Mr. Chairman.

Senator BINGAMAN. That will conclude the hearing.

[Whereupon, at 12:51 p.m., the committee adjourned, subject to the call of the Chair.]

[The following written questions and answers were subsequently supplied for the record:]

RESPONSES OF HON. JOHN L. MARTIN TO ADDITIONAL WRITTEN QUESTIONS POSED BY SENATOR D'AMATO

STATE OF MAINE
HOUSE OF REPRESENTATIVES
SPEAKER'S OFFICE
AUGUSTA, MAINE 04333

JOHN L. MARTIN
SPEAKER

November 17, 1988

The Honorable Paul S. Sarbanes
Chairman
Joint Economic Committee
Congress of the United States
Washington, D.C. 20510

Dear Chairman Sarbanes:

Thank you for your follow-up letter regarding my testimony before the Joint Economic Committee. It was my pleasure to be invited to address such an impressive and important Committee.

As I hope my testimony pointed out, rural development is a tremendously important issue for the entire nation, but it does not stand alone. Economic development impacts not only rural states like Maine, but it will also greatly impact the future competitiveness of America. I am pleased that your Committee has decided to look more closely at the issue. My hope is that the Committee will conclude that economic development, in general, is an area which deserves additional federal resources as well as increased and continued attention.

In response to the new questions posed by Senator D'amato, I would offer the following:

In view of today's global markets, how must the rural economy adjust to remain competitive?

Like every other sector of our economy, the rural economy must become more productive. It must produce a quality product at a reduced cost. Furthermore, it must stand behind the products it produces. It must be aggressive and innovative, always looking to new markets and enhanced production methods.

We must encourage the businesses that make up the rural economy to invest their limited capital resources into research and development. Research and development are areas of vital importance to this country's economic stability and thus, our future. As such, government should encourage investment in these areas.

If a company is willing to invest in research and development -- we (State and Federal Government) should be willing to reward that investment. This could be accomplished through a more progressive tax policy. I have enclosed a brochure that describes a program we have recently implemented in Maine which, I believe, is a step in the right direction. Perhaps a similar program could be adopted at the national level.

What can rural areas do to become more attractive to industries looking to relocate?

This question presupposes that it would be "good" for industry to relocate from one area of the country (city/metropolitan/urban) to another, that being the rural area. I hope that I have made the point that this is not necessarily what we should be encouraging. While I would not argue that this is a somewhat simplistic rebuttal, all you are doing here is robbing Peter to pay Paul. I am sure that New York City isn't wild about losing its manufacturing base to rural America! Nor should they be!

We must begin thinking in terms of America vs. Japan and Korea, not rural America vs. urban America. The nation doesn't benefit when a company in Alabama moves to Maine. Only Maine does. However, the entire nation benefits when Detroit automakers produce more cars for sale overseas. Similarly, America benefits when companies such as G.H. Bass and Nike choose to keep their production facilities in the United States as opposed to exporting those jobs overseas.

How has airline deregulation impacted growth in rural areas?

I do not claim to be an expert in this area. I would, however, argue that because the airline industry is constantly competing for increased market share, they are going to go where the customers are. Quite simply, that is not rural America. Moreover, I do not believe rural America has benefited from decreased fares. In fact, the contrary appears to be the case. Witness the enclosed article about landing fees at Boston's Logan International. The losers here are small rural states like Maine, Vermont and New Hampshire. If airline deregulation has impacted growth in rural areas, I would have to say that it has done so in a negative manner.

In the past decade much of the increase in employment in the United States has been in the service sector and it is often argued that rural areas should now try to expand service industry employment as an alternative to long-established industrial employment opportunities. Do you see this as a real option in your state? If so, what will it take to bring about such a transformation of the economic base?

From my own personal perspective, I do not think we should be encouraging or facilitating a movement into service industry employment. To be sure, a job in the service sector is better than no job at all. However, I believe we can achieve a much better return on our investment if we put our energies and resources into manufacturing and value-added jobs. The service economy will take care of itself, as has taken place in coastal and southern Maine along with isolated pockets of northwestern Maine.

Unfortunately, service industry jobs have a tendency to pay lower wages, and they do not necessarily add to the value of our economy. We must encourage the creation of job opportunities which create new, good paying employment opportunities. We must encourage enterprises which add to our economy, not just transfer wealth.

As state governments take on a larger role in economic development, do you see greater disparities among states in your region in terms of their ability to provide necessary services to their residents and attract new businesses? What problems, if any, will result from such differences? Does the Federal government have a role to play in preventing or remedying very sharp disparities in economic development among the states?

It seems to me that the answers to these questions are obvious. States like Maine do not have an infinite amount of resources at their disposal. While no state does, it stands to reason that California and Florida are better able to replace the programs being abandoned by the Federal government than Maine and Vermont.

The problem could be the creation of a new rust belt or worse, built-in depression. I would certainly agree that the Federal government should play a role in insuring that all Americans have access to equal opportunity. That includes stepping in to help prevent or remedy sharp disparities in economic development.

This gets back to my earlier remarks. We should be talking about one America vs. the World. We should never separate the big and the small, the rich and the poor, the haves and the have nots. We must continuously be reminded that America is one nation and not fifty independent free standing states. By working together, and not against one another, we can better serve the interests of all American citizens.

Pressing budget problems are likely to limit the federal funds available for rural development assistance programs. As a result, there is likely to be a strong interest in programs which require state and/or local matching funds. What advantages and problems for your states do you see in these programs.

As I stated in my testimony before the Committee, one of the most important ways for the Federal government to assist states during this current budget problem is to continue the Small Issue Industrial Development Bond Program. I need not elaborate further on my reasons, having already done so, but I did want to remind you of my concerns with the phase-out of this program. As for federal programs that require state and/or local matching funds, I have always felt that matching fund programs usually result in more prudent expenditures by federal, state and local governments. The problem is that states which can afford to take part in the programs will do so, the states that can not afford to do so will not. Once again, the haves versus the have nots.

Once again Chairman Sarbanes, I want to express my sincere thanks to you and the members of the Joint Economic Committee for allowing me the opportunity to make my presentation before the committee. I am grateful for your consideration. I hope you will not hesitate to contact me whenever I might be able to assist you.

Sincerely,

John L. Martin
Speaker of the House

enclosures

JLM/rc

FINANCE AUTHORITY OF MAINE

Maine Seed Capital Tax Credit Program

Enhancing Equity Investments in Young Business Ventures

FAME

FACT SHEET

Maine Seed Capital Tax Credit Program

SUMMARY: *Businesses need equity capital in the early development stages before they reach profitability and can obtain debt financing. In order to encourage equity investments in young business ventures, FAME may authorize State income tax credits to investors in an amount equal to 30% of the cash equity they provide to eligible Maine businesses.*

ELIGIBLE BUSINESSES MUST:

- *Be for profit and organized as a corporation, partnership, or joint venture.*
- *Have annual sales in the last 12 month period for which financial statements are available of no more than $200,000.*
- *Sell, or project to sell, more than 60% of their goods or services outside of the State.*
- *Be the full-time professional activity of at least one of the principal owners, each of whom is an individual.*
- *Not be primarily distribution, construction, transportation, financial services, insurance, or real estate businesses.*

ELIGIBLE INVESTORS MUST:

- *Own less than 50% of the business in which application for credit is being made. However, investors may participate in the operation of the business.*
- *Not be principal owners or an immediate relative.*

ELIGIBLE INVESTMENTS MUST:

- *Be in cash and used for fixed assets, research and development, or working capital, and not for repayment of equity investment.*
- *Be at risk in the business, which means the investment is unsecured and unguaranteed and remains in the business for 5 years with no interest or dividends paid to the investor during that period.*
- *Be made only after application for the tax credit.*

TAX CREDITS:

- *Are available to investots who provide between $10,000 and $50,000 per business. There is no limit on the number of businesses in which an investor can invest and for which he receives tax credits.*
- *Are available for aggregate investments of between $25,000 and $250,000 per business.*
- *Will be authorized in an amount of up to 30% of eligible investments. The credits may be taken over a minimum of 2 years and a maximum of 15 years, and may begin in the year of the investment.*

TAX CREDIT AUTHORIZATION:

- *A total of $2,000,000 in aggregate credits is available on the following schedule:*
  $700,000 until July, 1989,
  $650,000 between July, 1989 and June, 1990, and
  $650,000 between July, 1990 and June, 1991.
- *Includes $500,000 each targeted to:*
  JOB OPPORTUNITY ZONES - Presque Isle area, Millinocket area, Eastport area, and Waldo County
  NATURAL RESOURCE BUSINESSES - production, processing and marketing of agricultural, fisheries and forest products

APPLICATION PROCESS:

- *Both the investor and principal business owner complete a Maine Seed Capital Tax Credit Application.*
- *FAME processes applications in the order of receipt. In the event that the annual limitation on credits is reached, subsequent applications have priority for credit available in the following year.*
- *Upon determination of eligibility, FAME issues a letter to the investor authorizing a credit and annually notifies the State Tax Assessor.*

NOTE: Investors make their own investment decisions. The authorization of tax credits by FAME does not imply approval or endorsement of a business or the prudence of an investment, and FAME is held harmless in the event of loss. FAME may audit participating investors and businesses to ensure compliance with laws governing this program, and may attach conditions to the tax credit. Credits may be revoked or recaptured in full or in part if any false representations are made, if legal requirements are violated, or if conditions established by FAME are violated.

OTHER FAME PROGRAMS: *The Finance Authority of Maine has a number of other programs designed to help Maine's business community meet its financial needs. These programs include:*

LOAN INSURANCE:
- *Commercial Loan Insurance Program*
- *Leveraged Insurance Program*
- *Small Business*
- *Veterans' Small Business*
- *Natural Resources*
- *Export Insurance*

GRANTS:
- *Pine Tree Grant Program*
- *Opportunity Zone Job Grants Program*

TARGETED LENDING:
- *Job Start Program*
- *Development Fund Program*
- *Potato Marketing Improvement Fund*
- *Energy Conservation Loan Program*
- *Occupational Safety Loan Program*
- *Underground Oil Storage Facility Program*
- *Overboard Discharge Replacement Program*
- *Linked Investment Program for Agriculture*
- *Linked Investment Program for Commercial Enterprises*

TAXABLE BONDS:
- *SMART Bond Program*

TAX-EXEMPT BONDS:
- *SMART-E Bond Program*

Finance Authority of Maine
83 Western Avenue
P.O. Box 949
Augusta, Maine 04330
(207) 623-3263
(207) 623-FAME
FAX (207) 623-0095

FLYING

MST 5-15-88

Mainers caught in storm over Logan

Aviation

Portland passengers headed for Boston face higher ticket prices on some flights.

Landing-fee hike will hurt commuters, but airport claims it will benefit majority of passengers

By Paul Carrier
Guy Gannett Service

AUGUSTA — A plan to boost some landing fees for small planes at Boston's Logan International Airport has Maine's commuter airlines and charter operators predicting higher ticket prices and service cutbacks.

Scheduled to take effect July 1, the new fees would boost the cost of flying small planes — so-called general-aviation — into the nation's 10th-busiest airport, while lowering the costs for commercial jets to land there.

Massport, the state agency in Massachusetts that operates Logan, insists the change in landing fees will curtail the number of flights into Boston and relieve congestion by eliminating existing pricing subsidies for smaller aircraft.

"What we are trying to do is manage Logan in a way that will increase its value and capacity for everyone who uses it," said Tom Champion, the No. 2 man at Massport. "That helps everybody."

But commuter lines such as Eastern Express and Business Express, which provide dozens of daily flights from Maine to Boston, have joined forces with charter services in condemning what they view as a discriminatory plan that will force them to charge more or fly less.

"I think what will happen in Maine is you'll see a reduction in service because there will be fewer people willing to pay that (higher ticket) price," said Frank Arciuolo of Business Express, which flies to Boston from Portland, Bangor and Presque Isle.

While nonstop commuter flights from some Maine airports — notably Rockland, Presque Isle, Auburn, Bar Harbor and possibly Augusta — will be exempted from the higher fees, all commuter flights from Portland and Bangor will pay more. So will all charter flights and all private aircraft from all Maine airports.

"I think it's ridiculous," said Peter Caliendo of the Central Maine Flying Service in Old Town, which flies charters to Boston. "General aviation does not cause delays at Logan. It's a small portion of their traffic down there."

The debate is so highly charged that both camps disagree on virtually every aspect of the issue, including the question that lies at the heart of the controversy: Has Logan International reached the breaking point, or could it expand to accommodate everyone?

Equally contentious is a dispute over Logan's basic mission: Does the airport exist to shepherd hordes of commercial-airline passengers through its gates as quickly as possible, as Massport contends? Or is it duty-bound to give equal treatment to all types of aircraft, however small, as commuter lines and others suggest?

"The general aviation people feel we ought to be moving planes," said Stephen Martin, a Massport economist, "and (Massport) thinks we ought to be moving passengers."

Massport's statistics suggest that the agency has its hands full.

More than 414,000 planes carried 23.2 million people to and from Boston last year, making it one of the most heavily used in the country.

Most of those planes — about 248,000, or close to 60 percent — were commercial jets carrying dozens or hundreds of passengers, according to Massport, but the airport also served more than 124,000 smaller planes that flew commuter routes in the Northeast, as well as 41,863 private aircraft and charter flights.

Those commuter planes, charters and private aircraft, which represented 40 percent of the flights, ferried a mere 5 percent of Logan's passengers.

The result, according to Massport, is a glut in the skies over Boston and ever-longer holding patterns, as tiny and mid-sized planes carrying a handful of people compete with giant jetliners for landing space.

In less-than-perfect weather, incoming flights can expect to circle over Boston for 65 minutes during peak periods, according to

Please Turn to Page 35A

Maine to Logan International

Number of round-trip passengers on nonstop commuter flights from Maine airports to Logan International Airport in Boston from July 1986 to July 1987

Maine Airports	Round-trip passengers
Portland	107,962
Bangor	48,861
Augusta	40,295
Presque Isle	20,997
Rockland	19,154
Bar Harbor	16,037
Waterville	2,451
Auburn	1,612

Source: Regional Airline Association

Maine Sunday Telegram, May 15, 1988

Mainers caught in storm over Logan Airport fees

Continued from first page this section

Massport, which reports that holding patterns are expected to run more than an hour and a half by 1990.

"You have one general-aviation guy coming in who is not paying the full freight," said Martin, "and he's holding up 125 people."

Commuter airlines and other fliers concede that Logan is plagued by traffic jams, but they contend that Massport should add another runway to serve smaller aircraft instead of trying to cut the number of commuter flights and divert some small planes to nearby airports.

"It's unfair. There's no real basis for it," said Portland attorney Martin Amick, who heads the 1,000-member Maine Pilots Association. "Boston is still an under-utilized airport. It's not operating at full capacity."

Amick and others say the use of federal funds to build and expand Logan entitles all pilots and passengers to share the airport on an equal footing, regardless of the size of their aircraft or the number of people aboard.

And they argue that Logan, as the entry point to New England's largest city and the hub for connecting flights to destinations throughout the world, is a regional resource that should not be operated as the private preserve of Massachusetts.

Massport officials insist they recognize Logan's standing as an airport serving all of New England, noting that some of the commercial airline passengers inconvenienced by landing delays are flying from Maine to Boston aboard Delta Airlines.

But David Davis, Massport's executive director, rejects the idea that Logan should add a new runway for general aviation, saying the proposal has been discarded for environmental reasons.

"If I built another runway, I would be exposing (tens of thousands of people) to additional noise," Davis said. "People should understand that has been considered and reconsidered. It's like beating a dead horse."

Massport's solution to the overcrowding problem, which is being challenged in U.S. District Court and before the Federal Aviation Administration, would alter the formula used to calculate landing fees.

Specifically, the fee would change from $1.31 per 1,000 pounds of aircraft, with a $25 minimum, to a flat rate of about $88 per plane, plus 47 cents per 1,000 pounds.

The upshot is that commuter planes and other general-aviation aircraft, some of which now pay as little as $25 to land in Boston, will pay substantially more, according to Steven Mason of Eastern Express, and heavier commercial jets will pay less.

"The cost of landing a jumbo jet at Logan will go down by almost half," said Champion, "and the cost of landing a small aircraft will go up by about 250 percent."

Airport managers believe the new fees will curtail landings by small aircraft carrying few passengers, making it easier for large commercial jets to fly in.

Not only will commuter lines trim the number of flights to Boston by buying larger aircraft, Davis reasons, but other general-aviation fliers, such as charter companies and private pilots, will bypass Logan and use smaller airports within 20 miles of Boston.

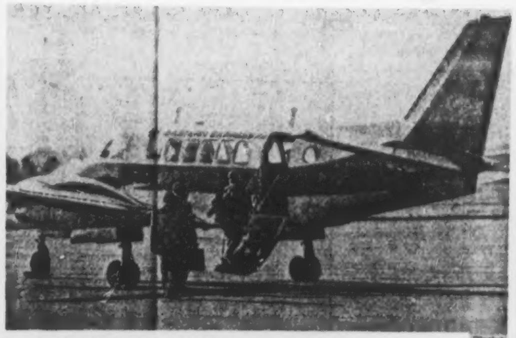
But commuter lines and charter pilots believe Massport's predictions are flawed on several counts.

Mason, the director of sales and advertising for Eastern Express, said his company will pay an extra $1.8 million in landing fees under the new rates, forcing a hike of about $10 per ticket.

Yet Massport expects Eastern Express, which runs most of its Maine-to-Boston flights on 19-seat planes, to invest millions in new equipment while trying to protect its share of the market from commercial airlines that will get a break on their landing fees.

"One way to interfere with our ability to use larger equipment is to add $1.8 million to our expenses," said Mason.

Commuter airlines also argue that switching to a smaller fleet of larger aircraft and reducing the number of flights to Boston would rob them of one of their biggest selling points: frequent, convenient flights to and from Boston.



File photo

Passengers board an Eastern Express plane. The commuter airline claims new Logan landing fees favor larger carriers.

"The airline does not dictate the size of aircraft to the market. The market dictates to the industry," said Arciuolo. "You don't want to travel on a DC 9 at 10 o'clock. You want to travel on any kind of aircraft at 7 o'clock, so you get there when you want to get there."

In addition to reducing the number of commuter flights by promoting the use of larger planes, Massport also hopes higher landing fees will divert recreational pilots and charter flights to airports within driving distance of Boston.

But Hanscom Field in nearby Bedford, Mass., often cited by Massport as an alternative to Logan because it is only 12 miles from Boston, "is not as handy to the city," said Callendo. "Typically, people want to go directly where they want to be."

If landing fees increase, Callendo said, he and other Maine charter operators face a no-win situation. They will have to increase ticket prices for flights to Boston or give their passengers, many of them businessmen on tight schedules, the equally unpleasant option of getting into Boston from a suburban airport.

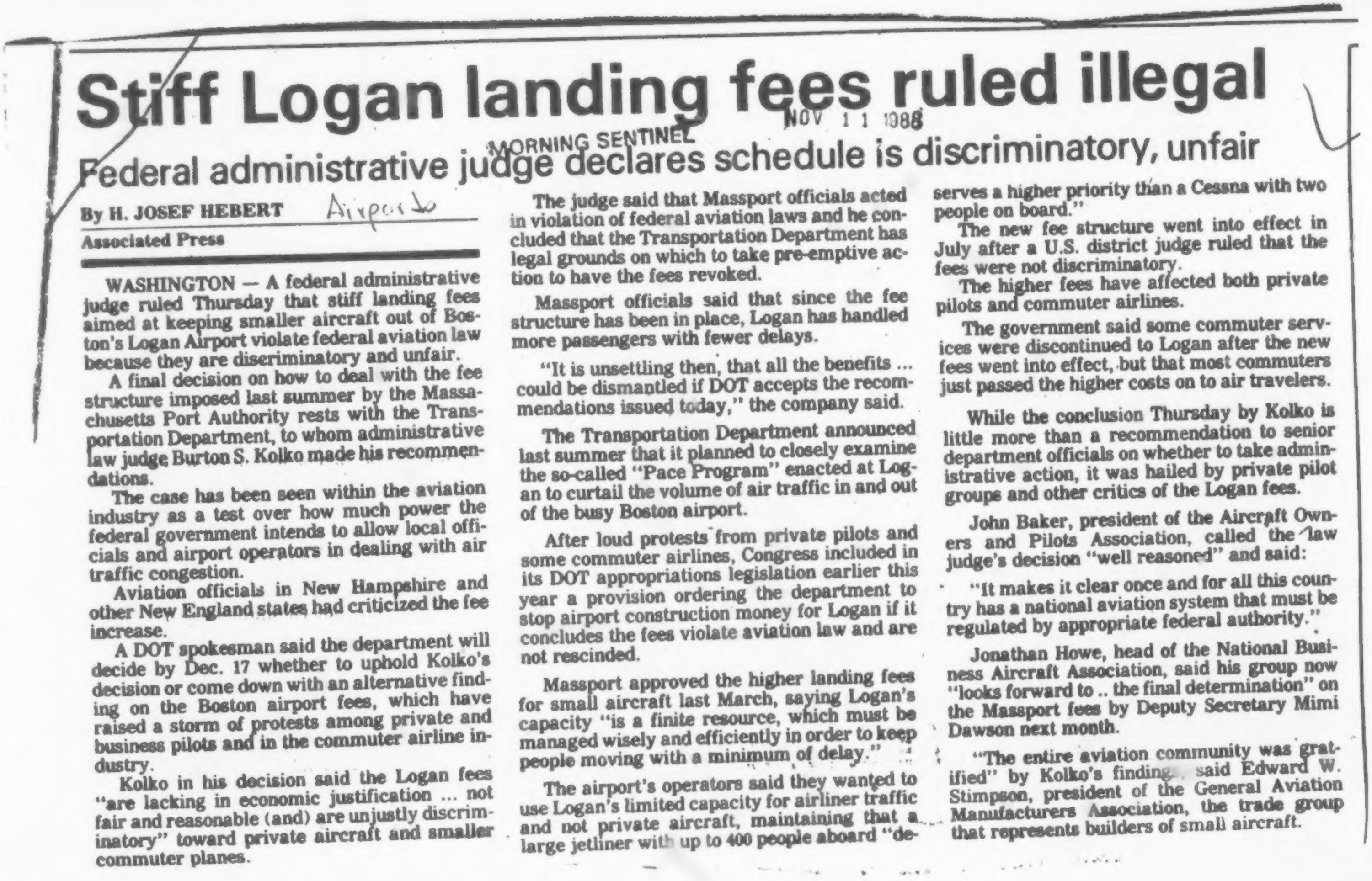
Fearing higher operating costs and a loss of business, commuter airlines have signed up with other critics of the plan to file legal challenges in Boston's U.S. District Court.

The suits question Massport's jurisdiction, allege discrimination and recommend expansion of Logan if, in fact, small aircraft are a major cause of congestion, a claim rejected by commuter lines and charter operators.

"I don't think there is a problem at Logan involving general aviation," said Amick. "Kicking out general aviation is not going to affect that (logjam) the slightest bit."

Massport is holding firm in the face of such challenges, insisting it will not cave in to special-interest groups that do not represent the vast majority of air travelers.

If higher landing fees cut small-plane traffic by 5 percent, Davis said, "you will perhaps inconvenience 40 people during a peak hour, and you will cut the delay for 7,000 people during that hour."



Stiff Logan landing fees ruled illegal

MORNING SENTINEL NOV 11 1988

Federal administrative judge declares schedule is discriminatory, unfair

By H. JOSEF HEBERT Airports

Associated Press

WASHINGTON — A federal administrative judge ruled Thursday that stiff landing fees aimed at keeping smaller aircraft out of Boston's Logan Airport violate federal aviation law because they are discriminatory and unfair.

A final decision on how to deal with the fee structure imposed last summer by the Massachusetts Port Authority rests with the Transportation Department, to whom administrative law judge Burton S. Kolko made his recommendations.

The case has been seen within the aviation industry as a test over how much power the federal government intends to allow local officials and airport operators in dealing with air traffic congestion.

Aviation officials in New Hampshire and other New England states had criticized the fee increase.

A DOT spokesman said the department will decide by Dec. 17 whether to uphold Kolko's decision or come down with an alternative finding on the Boston airport fees, which have raised a storm of protests among private and business pilots and in the commuter airline industry.

Kolko in his decision said the Logan fees "are lacking in economic justification ... not fair and reasonable (and) are unjustly discriminatory" toward private aircraft and smaller commuter planes.

The judge said that Massport officials acted in violation of federal aviation laws and he concluded that the Transportation Department has legal grounds on which to take pre-emptive action to have the fees revoked.

Massport officials said that since the fee structure has been in place, Logan has handled more passengers with fewer delays.

"It is unsettling then, that all the benefits ... could be dismantled if DOT accepts the recommendations issued today," the company said.

The Transportation Department announced last summer that it planned to closely examine the so-called "Pace Program" enacted at Logan to curtail the volume of air traffic in and out of the busy Boston airport.

After loud protests from private pilots and some commuter airlines, Congress included in its DOT appropriations legislation earlier this year a provision ordering the department to stop airport construction money for Logan if it concludes the fees violate aviation law and are not rescinded.

Massport approved the higher landing fees for small aircraft last March, saying Logan's capacity "is a finite resource, which must be managed wisely and efficiently in order to keep people moving with a minimum of delay."

The airport's operators said they wanted to use Logan's limited capacity for airliner traffic and not private aircraft, maintaining that a large jetliner with up to 400 people aboard "deserves a higher priority than a Cessna with two people on board."

The new fee structure went into effect in July after a U.S. district judge ruled that the fees were not discriminatory.

The higher fees have affected both private pilots and commuter airlines.

The government said some commuter services were discontinued to Logan after the new fees went into effect, but that most commuters just passed the higher costs on to air travelers.

While the conclusion Thursday by Kolko is little more than a recommendation to senior department officials on whether to take administrative action, it was hailed by private pilot groups and other critics of the Logan fees.

John Baker, president of the Aircraft Owners and Pilots Association, called the law judge's decision "well reasoned" and said:

"It makes it clear once and for all this country has a national aviation system that must be regulated by appropriate federal authority."

Jonathan Howe, head of the National Business Aircraft Association, said his group now "looks forward to .. the final determination" on the Massport fees by Deputy Secretary Mimi Dawson next month.

"The entire aviation community was gratified" by Kolko's findings, said Edward W. Stimpson, president of the General Aviation Manufacturers Association, the trade group that represents builders of small aircraft.

RESPONSES OF HON. BILL SIMS TO ADDITIONAL WRITTEN QUESTIONS POSED BY SENATOR D'AMATO AND THE COMMITTEE

The Senate of The State of Texas

BILL SIMS
STATE SENATOR
25TH SENATORIAL DISTRICT

ROOM 421, CAPITOL BUILDING
AUSTIN, TEXAS 78711-2068
512/463-0125

COMMITTEES:
ECONOMIC DEVELOPMENT
INTERGOVERNMENTAL
RELATIONS
NATURAL RESOURCES
VICE CHAIRMAN
SUBCOMMITTEE ON AGRICULTURE

January 5, 1989

The Honorable Paul S. Sarbanes
Congress of the United States
Joint Economic Committee
Washington, D.C. 20510

Dear Senator Sarbanes:

I apologize for being so tardy in replying to your letter. However, things have been moving pretty fast but I would like to answer you since I felt like it would be awhile before there would be any action taken on the problem of rural America.

The first question from Senator D'Amato is in view of today's global markets. How must the rural economy adjust to remain competitive? Well, of course, the first thing you have to look at is whether or not the products that are being sold in competition to the American farmer or producer are being heavily subsidized in their own country. In many cases, certainly New Zealand did subsidize their lamb to a very great extent. I know that we are having a problem with EEC right now. They receive a very high subsidy. Then they sell their products cheaper over here than we can. Of course, our cost of production is much higher than other peoples are and consequently we have an unlevel playing field syndrome which we are all experiencing. If the producers of rural America were able to play on a level field with the producers of foreign countries, I think we could be very competitive. There is no doubt in my mind that we can raise cotton or grain sorghums, sheep, cattle, hogs, what have you, much more efficiently than most or if not all of our competitors. However, then we get into this unlevel situation.

We have free trade but no fair trade. I am a very strong believer in the farm programs. I feel that this does allow the leveling of the field so to speak but also the American producer is the person who would be the food grower or producer if we got into a war situation.

In the event of war, there would not be much food if any coming into the United States. If we buy too much overseas and do not allow our producers to exist then we put them out of business and then we end up without anybody to raise our products in case of a national emergency. We must maintain a strong production and the only way we can ensure that is through a very strong subsidy program. Why don't we charge the so called farm program to the defense budget because we are raising food for defense. We are keeping these people in production so that if we do get into a war situation we will have the people to produce the products.

The second question is what can rural areas do to become more attractive to industries looking to relocate? In Texas, the main things we are seeing is that your major industries like to locate near the industrial hubs or the travel centers such as Dallas/Ft. Worth and Houston. The people that work in these industries prefer the larger cities so that they will have the advantages that they had when they lived in New York or Atlanta or wherever they are coming from. It is going to be slow getting big industry to accept the smaller areas. I foresee a time when the tax credits and the low taxes and the availability of rural employees will certainly be attractive to major industries. I guess air transportation is one of the limiting factors for much of Texas because if you don't live in Ft. Worth, Dallas, Houston, San Antonio or Austin you are not going to get real good air travel. People now are demanding this to relocate.

I think a major advantage that Texas now has and I think we are going to see accelerated, is the Maquilador program where the Americans and the Mexicans cooperate on plants on both sides of the border. This gives the manufacturer in the United States a salary advantage at least equal to those in the Asiatic countries. This is very convenient and very attractive to many industries with your plants in Mexico right across the border. Certainly, El Paso has taken advantage of this. There are more than 150 Maquilador plants in that area. The Brownsville area has some 50 or so. The Del Rio area probably 35 to 40 and these are going to continue growing because American management likes to see their source of product within a few hundred miles. This will help some of the rural areas along the border and particularly it is going to be a great shot in the arm for the Mexican citizens who work in these plants and remain in Mexico and do a tremendous job. I really don't see much chance in plants wanting to really locate in our rural areas.

Another major problem is medical availability in your rural areas. Hospitals in many of our small places have closed doors because they couldn't finance it. We are going to have to see something happen to overcome this problem. I think there is probably a possibility that the federal and state government could cooperate on some programs for rural health that are absolutely necessary or we are going to see even a greater number of people leaving our rural areas of Texas. For awhile it looked like a lot of small rural areas particularly in the Hill Country in the central part of Texas was going to have a large retired population coming from the North, however, they have slowed down some because of the lack of health treatment and they are migrating back toward the Austin/San Antonio areas where there is already plenty of people. They need to be disbursed more but because of rural health we can't get it done.

The last question is how has airline deregulation impacted growth in rural areas? Deregulation hurt the San Angelo market very badly because when we had regulation carriers we could afford to bring in a good sized airplane into the San Angelo area. I think we are comparable to the South Texas and many of the smaller areas of Texas: College Station/Bryan, East Texas areas, Kilgore, Marshall. After the deregulation, the larger carrier could not compete because we started getting people bringing in smaller commuter planes with 10, 12 and 15 seats. Then these companies would be going and they would go broke then we would find another. They just were not able to charge the tariff that they could be assured of a share of the market so they could plan for the future. It has hurt the rural areas of Texas very much and I doubt that we will ever see the assurance of air travel that we had prior to the deregulation.

Now I would like to address some other comments that have come from the committee. Also, the additional questions. The first one was whether or not the service industry could be established in rural Texas in place of the industrial employment? I guess the difference we have in rural Texas is that the industrial employment was farm and ranch work. There is no way these areas or people could be converted into service oriented people because it is just the nature of the business.

The second question as to state government taking a larger roll in economic development, do you see greater disparities among states in our region in terms of their ability to provide necessary services to their residents and attract new businesses. What problems, if any, will result from such differences? Yes, I can see a real problem that the other states may have with Texas in that 5 or 6 major metropolitan areas have a tremendous ability to have services as well as the necessary travel. Most of them have major universities nearby or in them and also the state still has enough financial stability that we can give tremendous advantages to various industries moving in. Of course, I think a good example would be Penny's moving into Dallas as well as General Telephone and the superconductor being put in Texas if funding can be established. The state legislature voted to support the project by $1 billion.

We do have money. We have good resources. We are able to attract the major industries into our state. There is no doubt that it could have an adverse affect on the surrounding states. I think the Maquilador program could also be a very strong asset to Texas also because of cheap labor. We could draw even more in and that is going to be an even more severe disadvantage to some of the surrounding states. I see some real problems developing. As far as I am concerned there is not a thing we can do about it.

The last question was because of pressing budget problems with federal funds and because states will be getting less money, how would the states look at state and/or local matching funds. Do you see any advantages and problems for our state? No, I think the matching fund program will work out very well. I can see matching funds with the federal would be a good idea. I think we need to see it. I think we get more federal funds than we probably should and if the local people want to participate they are going to have to come up with the money to do it. Particularly if these are local projects that would initially benefit the people of the state or the area that they affect. I see no real problem with it. I think it will work out.

I recognize that I have probably answered your questions more than you wanted. You can certainly use or not use whatever you like. I have also enclosed a copy of my testimony which I tried to correct. Again, I enjoyed the experience of visiting with ya'll.

Sincerely yours,

Bill Sims.

Bill Sims

BS/sa

Enclosure

RESPONSES OF MURRAY D. LULL TO ADDITIONAL WRITTEN QUESTIONS POSED BY THE COMMITTEE

SENATE

PAUL S. SARBANES, MARYLAND,
CHAIRMAN
WILLIAM PROXMIRE, WISCONSIN
LLOYD BENTSEN, TEXAS
EDWARD M. KENNEDY, MASSACHUSETTS
JOHN MELCHER, MONTANA
JEFF BINGAMAN, NEW MEXICO
WILLIAM V. ROTH, Jr., DELAWARE
STEVE SYMMS, IDAHO
ALFONSE M. D'AMATO, NEW YORK
PETE WILSON, CALIFORNIA

JUDITH DAVISON,
EXECUTIVE DIRECTOR

Congress of the United States
JOINT ECONOMIC COMMITTEE
(CREATED PURSUANT TO SEC. 5(a) OF PUBLIC LAW 304, 79TH CONGRESS)
Washington, DC 20510

HOUSE [illegible]RESENTATIVES

LEE H. [illegible], INDIANA,
VICE CHA[illegible]N
AUGUSTUS F. HAWKINS, CALIFORNIA
DAVID R. OBEY, WISCONSIN
JAMES H. SCHEUER, NEW YORK
FORTNEY H. (PETE) STARK, CALIFORNIA
STEPHEN J. SOLARZ, NEW YORK
CHALMERS P. WYLIE, OHIO
OLYMPIA J. SNOWE, MAINE
HAMILTON FISH, Jr., NEW YORK
J. ALEX McMILLAN, NORTH CAROLINA

October 24, 1988

Mr. Murray D. Lull, President
Smith Co. Bank & Trust
American Bankers Association
136 South Main Street
Smith Center, Kansas 66967

Dear Mr. Lull:

A careful review of your written and verbal testimony to the Joint Economic Committee hearing on September 28 on "Rural Development in the 1990's" has raised several additional questions to which the Committee would welcome your observations; a written response, if time permits, would contribute significantly to the Committee's work.

Since we hope to have the hearing results printed before the end of the year a timely response would be greatly appreciated. Once again, please accept my thanks for your participation in the hearing on rural development and your interest in the Committee's work.

With best regards,

Sincerely,

Paul Sarbanes

Paul S. Sarbanes
Chairman

PSS/jds

SUPPLEMENTAL QUESTIONS

In their testimony both Mr. Cassidy and Mr. Larochelle suggested the existence of a "credit gap" in rural America. Mr. Lull and Mr. Spies both argued that ample credit is available for qualified borrowers. To help the Committee better understand this very important issue could you respond to the following questions:

> What do you understand the term "credit gap" to mean?
>
> Mr Spies indicated that loan-to-deposit ratios in rural banks are at relatively low levels. Is this ratio consistent with the existence of a credit gap? If it is not, what can be done to expand the number of loans banks consider credit-worthy in rural areas?
>
> Are there good reasons for the cost of credit to be higher in rural areas than in urban centers? If so, how would one go about determining what is an appropriate differential?
>
> What alternatives or modifications to current Federal credit programs available to rural areas would your organization consider appropriate?
>
> Has deregulation of the financial service industry served to increase, decrease or leave unchanged the supply of credit available for rural lending?

THE SMITH COUNTY STATE BANK
AND TRUST COMPANY
SMITH CENTER, KANSAS

MURRAY D. LULL
President

November 25, 1988

The Honorable Paul Sarbanes
Chairman, Joint Economic Committee
Congress of the United States
SD-G01
1st and C Streets, N.E.
Washington, D.C. 20510

Dear Chairman Sarbanes,

Responding to the opportunity to answer additional questions you submitted to me on October 24 regarding my testimony on "Rural Development in the 1990's" to the Joint Economic Committee on September 28, please find my answers attached.

Should any of the responses require amplification, or if you have additional questions, I would be pleased to respond.

On behalf of the American Bankers Association, I would like to express our appreciation to the Committee for its interest in Rural Development, and for our opportunity to take part in its discussion. Our mutual efforts will surely decide the fate of many rural areas such as mine.

Thank you for your consideration.

Sincerely,

Murray D. Lull
President, The Smith County State Bank and Trust Company
Smith Center, Kansas
and
Chairman, Agricultural Bankers Division
American Bankers Association
Washington, D.C.

P.O. BOX 307, SMITH CENTER, KANSAS 66967
(913) 282-6682

MURRAY D. LULL

RESPONSES TO ADDITIONAL QUESTIONS

TESTIMONY TO THE JOINT ECONOMIC COMMITTEE
ON "RURAL DEVELOPMENT IN 1990'S"

QUESTION: What do you understand the term "credit gap" to mean?

RESPONSE: The term "credit gap" would be generally perceived to mean that demand for credit exceeds supply or availability. In the context of rural development credit needs, as well as others, a "credit gap" may result, not from the actual physical lack of availability, but a lack of availability of credit to potential borrowers who do not meet certain requirements of bank regulators for safety and soundness considerations. This focus on safety and soundness requires the extension of credit to be accompanied by offsetting supports provided by the user of the credit. These supports include:

a) collateral, which in value should meet or exceed the amount of credit requested;
b) cash flow, which should equal or exceed the amounts needed to repay the credit and interest costs; or
c) in view of the lack of, or the marginal inadequacy of, collateral and/or cash flow, guarantees that assure the provider of credit that in default of repayment the provider would be reimbursed for its loss of the credit.

Government guarantees provided through the Small Business Administration, the Farmers Home Administration, and others often serve as supports for otherwise non-qualifying extensions of credit, but even these guarantees are predicated on the relative adequacy of collateral and cash flow. So-called credit gaps can exist even with the availability of government guarantees because of the guaranteeing agencies' requirements for collateral and/or cash flows that exceed those able to be met by the applicant.

Again, the use of the term "credit gap" in the context of rural development credit needs should not be interpreted as the literal and physical unavailability of bank credit. Rather, any credit gaps that might exist result primarily due to bank regulatory and safety and soundness considerations that even government guarantees have not been able to cover.

Interestingly, it seems the term is used most by those entities that wish to expand their authorities in lending, inferring that they might be somehow better able to deliver credit to recipients currently unable to be served by the already numerous conventional sources. Allowing new entities to lend money to borrowers who do not meet our current well-established credit standards would merely result in new entities without lending experience making risky loans.

QUESTION: Mr. Spies indicated that loan-to-deposit ratios in rural banks are at relatively low levels. Is this ratio consistent with the existence of a credit gap? If it is not, what can be done to expand the number of loans banks consider creditworthy in rural areas?

RESPONSE: It is true that in many rural banks, the loan-to-deposit ratio is at a relatively low level. In my conversations with many rural bankers, they consistently state that they desire to extend more credit in their areas, but are all experiencing distinct lacks of credit demands from applicants who meet bank regulatory and safety and soundness requirements. It is ironic that the term "credit gap" might be used by some in this environment, and such a term is not consistent with its traditional meaning. Perhaps those seeking a proper term would find "creditworthiness gap" more appropriate and explanatory of our rural frustrations in serving credit needs.

I believe that there is every incentive for rural banks to extend all the credit they possibly can consistent with regulatory and safety and soundness considerations. Economically, banks can earn greater returns if they can expand their volume of loans. There is no present disincentive to curtail credit on the basis of alternative investments of bank funds.

If it is true, and I believe that it is, that rural banks are making every effort to extend credit, consistent with the credit requirements that bank regulatory and safety and soundness considerations demand (including using wherever possible the addition of government guarantees to overcome collateral or cash flow shortfalls), then indications are that those requests for credit that cannot be met do not qualify for credit, even with the use of guarantees.

Occasionally, stories are related that someone has had what they thought was a rock-solid loan proposal for some great purpose that a lender had turned down for no reason at all, and that, thus, a potentially great enterprise for some community was stillborn. I have found that the great thing about competition among lenders is that a potential borrower, if turned down for whatever reason by one lender, has many more lenders to whom he can make his loan proposal. Logic says that if the proposal has any merit, the loan will likely be made. If the loan cannot be obtained, after proposing it to many, then very likely the proposal had basic deficiencies that even competitive pressures could not overcome.

Also, it is commonly misunderstood that the availability of a "government guarantee" overcomes all obstacles for credit consideration. Obtaining such guarantees on credit extensions often involve requirements on the part of the guarantee agencies that meet or even exceed those requirements individual banks might expect in their extensions of credit without the guarantees. In other words, it appears in some cases that the guarantee agencies wish to protect their interests from credit loss to a greater degree than the banks themselves might expect without an accompanying guarantee.

Moderation of the requirements that government agencies have installed for their guarantees would be appropriate in certain areas. One example would be the acceptance of a greater degree of risk by lessening the requirements for levels of collateral supporting credit extensions. Another would be to recognize and "give credit" to guaranteed loan applicants for elements such as experience, work-ethic, ability, "sweat-equity", and other inputs that currently by bank regulation and policy carry less weight in evaluating a guarantee request. These moderations would result in more risk to the guaranteeing agency, but it is a risk-reward relationship. We must remember that the Small Business Administration and the Farmers Home Administration were created to make more credit available, through guarantees, to deserving applicants that could not otherwise obtain credit.

It has been interesting, but disturbing, to note that over time, as some losses appeared in these agencies in covering the guarantees they issued, the agencies either felt the need, or were directed, to increase their credit standards to lessen their risks. This reduction of risk has gone on until, as I stated earlier, their standards in some cases meet or exceed those of our rural banks. In effect, it appears these agencies have lost their willingness to absorb risks that would otherwise allow the creation of new businesses and jobs in the rural areas they serve.

Regulatory requirements, driven by the safety and soundness imperatives of protecting our depositors' funds, are appropriate and time-tested in regard to our extensions of credit. Lessening these requirements in the past has resulted in unacceptable credit loss exposures which should not be revisited. However, these guarantee agencies were created to absorb and buffer many of these risks so the private sector could provide more credit while protecting their depositors' funds. A more acceptable balance between these goals (risk taking and safety and soundness) must be found if more credit is to be provided to start-up businesses.

QUESTION: Are there good reasons for the cost of credit to be higher in rural areas than in urban centers? If so, how would one go about determining what is an appropriate differential?

RESPONSE: It is arguable that no real differential exists in costs of credit between rural and urban borrowers if similar measurements are taken in determining creditworthiness and the lenders' costs of funds. All too often, a city lender's so-called prime rate, available only to the most creditworthy borrowers, is measured against a prevailing rate of interest in rural areas where there are no comparable borrowers. Deregulation and competition have given borrowers many places to seek credit and compare terms. If a rural borrower would measure his "rural" rate with a rate he would pay in borrowing from an urban bank, I doubt that any significant differential exists.

Our bank competes with many credit sources when we discuss loan terms, such as interest rates, with our customers. We know that if the terms we offer are not competitive, we will not be able to be the source of credit for our customers. As a result, we will not succeed in deploying funds that our bank wishes to lend.

Competition, and there is plenty of it, should determine rates. Rate differentials, if any, are minimized over a comparatively short time because of the mobility of the borrower and the abundance of credit sources. Measurements of so-called rate differentials often involve apple versus orange sets of issues. I do not feel there are significant apple versus apple differences in interest rates between urban and rural areas.

QUESTION: What alternatives or modifications to current Federal credit programs available to rural areas would your organization consider appropriate?

RESPONSE: As stated in an earlier response, moderation of the requirements that government agencies have installed for their guarantees would be appropriate in certain areas. The acceptance on the part of the guarantee agency of a greater degree of risk by lessening the requirements for levels of collateral supporting credit extensions would be one. Another would be to recognize and "give credit" to applicants for elements such as experience, work-ethic, ability, "sweat-equity", and other inputs that currently by bank regulation and policy carry considerably less weight in evaluating a guarantee request.

As discussed earlier, these moderations will result in more risk to the guaranteeing agency, but it is truly a risk-reward relationship. The Small Business Administration and the Farmers Home Administration were created to make more credit available, through guarantees, to deserving applicants that could not otherwise obtain credit. Notwithstanding the apparent trend toward risk avoidance on the part of these agencies, the guarantee programs have made productive credit available to many traditionally non-creditworthy, but otherwise deserving applicants. The mainstreet businesses, the farms, the homes, and of course the families and jobs these loans have made possible have had major positive impacts in our rural culture.

Another element that must be examined is the Federal budget "scoring" these guarantees carry. Consideration, on an actuarial basis, should be given to the real potential for loss in honoring guarantees issued, instead of treating the amounts of these guarantees as full expenditures. While losses in honoring guarantees must be measured, the guarantees that, through the successful borrower payback of guaranteed loans, are never exercised and thus are never an expenditure also must be considered.

The concept of government agency guarantees has been highly successful by many measurements. This concept, however, must be reexamined to ascertain that proper amounts of risk are being absorbed through the guarantee process to encourage appropriate extensions of credit to our rural areas.

At the same time, every effort must be continued to assure the safety and soundness of our depository institutions and to maintain our customers' confidence in our banks.

QUESTION: Has deregulation of the financial service industry served to increase, decrease, or leave unchanged the supply of credit available for rural lending?

RESPONSE: Deregulation has increased the competition for deposits in our rural banks. This relatively new competition is coming from insurance, securities, and other commercial businesses with credit and deposit-like functions that have never before competed for funds in my community. Significantly, this intense competition exists even though these industries rarely set foot in my trade area. Even if their advertisements and solicitations do not result in additional funds leaving my community to them, it certainly serves to increase the level of interest rates we pay to retain the funds in our banks. When we must pay more for deposits, we must charge higher rates for our loans to cover the cost of funds.

While it might be said that deposit levels have been generally sustained in most of our communities, those funds that do leave our communities NEVER come back in the form of credit for rural development. Those funds that we are able to retain have an accompanying higher cost of funds that necessarily make borrowing costs higher to our customers.

It also must be said that if the insurance and securities industries are competing for and taking our deposits, in the spirit of competition banking must be allowed to save our rural customers money by allowing our banks to compete with these industries. Fair is fair.

Even though the impact of deregulation has been very significant, the bottom line is that banks DO have ample funds to provide for rural borrowers and rural development.

The beautiful and hopeful element is that rural people, businesses, and communities have a great spirit and desire to sustain and expand our rural economies. Our frustrations are that our financial bases to do these things are extremely modest. Many credit applications, while rich with desire, ability, insight, and the will to succeed, are often too short of equity to qualify for loans that meet regulatory and safety and soundness concerns.

Over the years, loan guarantees have made a lot of difference in many rural communities. These programs should be reexamined and retuned to balance the right amount of benefit to our rural communities consistent with an acceptable level of risk to all concerned.

RESPONSES OF JOHN F. SPIES TO ADDITIONAL WRITTEN QUESTIONS POSED BY THE COMMITTEE

SENATE
PAUL S. SARBANES, MARYLAND,
CHAIRMAN
WILLIAM PROXMIRE, WISCONSIN
LLOYD BENTSEN, TEXAS
EDWARD M. KENNEDY, MASSACHUSETTS
JOHN MELCHER, MONTANA
JEFF BINGAMAN, NEW MEXICO
WILLIAM V. ROTH, JR., DELAWARE
STEVE SYMMS, IDAHO
ALFONSE M. D'AMATO, NEW YORK
PETE WILSON, CALIFORNIA

JUDITH DAVISON,
EXECUTIVE DIRECTOR

Congress of the United States
JOINT ECONOMIC COMMITTEE
(CREATED PURSUANT TO SEC. 5(a) OF PUBLIC LAW 304, 79TH CONGRESS)
Washington, DC 20510

HOUSE OF REPRESENTATIVES
LEE H. HAMILTON, INDIANA,
VICE CHAIRMAN
AUGUSTUS F. HAWKINS, CALIFORNIA
DAVID R. OBEY, WISCONSIN
JAMES H. SCHEUER, NEW YORK
FORTNEY H. (PETE) STARK, CALIFORNIA
STEPHEN J. SOLARZ, NEW YORK
CHALMERS P. WYLIE, OHIO
OLYMPIA J. SNOWE, MAINE
HAMILTON FISH, JR., NEW YORK
J. ALEX McMILLAN, NORTH CAROLINA

October 24, 1988

Mr. John F. Spies, President
Iowa Trust Savings Bank,
Emmetsberg, Iowa
Independent Bankers Association of America
One Thomas Circle NW
Washington, D.C. 20005

Dear Mr. Spies:

A careful review of your written and verbal testimony to the Joint Economic Committee hearing on September 28 on "Rural Development in the 1990's" has raised several additional questions to which the Committee would welcome your observations; a written response, if time permits, would contribute significantly to the Committee's work.

Since we hope to have the hearing results printed before the end of the year a timely response would be greatly appreciated. Once again, please accept my thanks for your participation in the hearing on rural development and your interest in the Committee's work.

With best regards,

Sincerely,

Paul Sarbanes

Paul S. Sarbanes
Chairman

PSS/jds

SUPPLEMENTAL QUESTIONS

In their testimony both Mr. Cassidy and Mr. Larochelle suggested the existence of a "credit gap" in rural America. Mr. Lull and Mr. Spies both argued that ample credit is available for qualified borrowers. To help the Committee better understand this very important issue could you respond to the following questions:

> What do you understand the term "credit gap" to mean?
>
> Mr Spies indicated that loan-to-deposit ratios in rural banks are at relatively low levels. Is this ratio consistent with the existence of a credit gap? If it is not, what can be done to expand the number of loans banks consider credit-worthy in rural areas?
>
> Are there good reasons for the cost of credit to be higher in rural areas than in urban centers? If so, how would one go about determining what is an appropriate differential?
>
> What alternatives or modifications to current Federal credit programs available to rural areas would your organization consider appropriate?
>
> Has deregulation of the financial service industry served to increase, decrease or leave unchanged the supply of credit available for rural lending?

Answers to questions by John Spies:

1. Question: What do you understand the term "credit gap" to mean?

Answer: I would think that there is a "credit gap" if ample credit is not available to borrowers who can qualify for credit on a commercial basis. Of course if you want to consider assisted credit, in the sense that credit is subsidized in some way, then clearly a credit gap may exist in rural areas. In general, I don't believe that it is a good practice to use subsidized credit on a broad geographical basis, although the use of some kind of financial assistance and incentives for infrastructure maintenance and building in rural areas certainly may be useful.

2. Question: Mr. Spies indicated that loan-to-deposit ratios in rural banks are at relatively low levels. Is this ratio consistent with the existence of a credit gap? If it is not, what can be done to expand the number of loans banks consider credit-worthy in rural areas?

Answer: I don't believe that relatively low loan-to-deposit ratios are a necessary indicator that there is a gap in credit, because you can certainly have more deposit funds flowing into banks than there are fundable loans, and particularly when the agricultural economy is rather depressed the loan demand relative to deposits can get quite low. Generally, banks must find alternative places to invest surplus funds (deposits) when loan demand is down. However, we are definitely interested in working with any individuals or firms that are in need of credit and can meet reasonable credit standards.

3. Are there good reasons for the cost of credit to be higher in rural areas than in urban centers? If so, how would one go about determining what is an appropriate differential?

Answer: I don't believe there is reason for credit to be higher in one geographical area or another simply because of the location. There may be underlying reasons for differentials in rates based upon the credit history of the borrower, the age and nature of the business involved, and other factors.

4. What alternatives or modifications to current Federal credit programs available to rural areas would your organization consider appropriate?

Answer: I mentioned in my testimony such steps as an expansion in government loan guarantees and the possible establishment of a government-sponsored secondary market for small business loans.

5. Question: Has deregulation of the financial service industry served to increase, decrease, or leave unchanged the supply of credit available for rural lending?

page 2

Answer: I think the dependability and quality of credit service in rural areas may be jeopardized with certain types of deregulation. For instance, geographical deregulation that opens the way for financial institutions to consolidate on an interstate basis and regionally will result in credit service that is less customized and responsive to small business and other borrowers in rural areas.

RESPONSES OF JACK E. CASSIDY TO ADDITIONAL WRITTEN QUESTIONS POSED BY THE COMMITTEE

Central Bank for Cooperatives

P.O. Box 5110
Denver, CO 80217
5500 South Quebec St.
Englewood, Colorado 80111
303/740-4000

December 5, 1988

Honorable Paul S. Sarbanes
Chairman
Joint Economic Committee
Washington, DC 20510

Dear Mr. Chairman:

Enclosed are my responses to questions raised in connection with the September 28 hearing on "Rural Development in the 1990's."

Thank you for the opportunity to testify on behalf of the Farm Credit System's Banks for Cooperatives. Please call on me at any time if I can be of assistance to you, the members of your committee or staff.

Sincerely,

Jack Cassidy
Vice President

Enclosure

Questions and Responses: "Rural Development in the 1990's" Hearing
Responses Prepared by Jack Cassidy

Question: What do you understand the term "credit gap" to mean?

Response: The term "credit gap" may be misleading. In general, we believe lenders have adequate funds available to finance rural projects. However, lenders generally make loans on the basis of return on assets and risk. Therefore, most lenders strive to channel loan funds into more profitable and less risky ventures. In many cases, this means a project that will create jobs in a given rural area may not be as attractive to a lender as many other types of loans or investment options.

I would point out that the Banks for Cooperatives and the Farm Credit System in general could be considered "dedicated lenders." That is, we exist solely to serve the credit needs of eligible borrowers that operate in rural areas.

Question: Mr. Spies indicated that loan-to-deposit ratios in rural banks are at relatively low levels. Is this ratio consistent with the existence of a credit gap? If it is not, what can be done to expand the number of loans banks consider credit-worthy in rural areas?

Response: One certain way to expand the availability of credit in rural areas is to increase the profitability of rural or agricultural loans or reduce the risk to lenders. In general, we have found that some government guarantee programs are helpful because they reduce risk to lenders.

Question: Are there good reasons for the cost of credit to be higher in rural areas than in urban centers? If so, how would one go about determining what is an appropriate differential?

Response: The Banks for Cooperatives have found that money center banks and investment bankers are willing and anxious to provide capital at competitive rates to large and financially strong cooperatives. Even though many large cooperatives have invested millions of dollars in stock in the Banks for Cooperatives, we must work very hard to provide services and competitive credit programs to retain present borrowers. Our ability to provide credit to hundreds of smaller cooperatives to a large degree depends on the banks being able to generate loan volume and earnings from larger accounts. However, most rural businesses do not have a "dedicated" lender to borrow from. Very large financially strong borrowers are able to obtain credit at reasonable rates while smaller companies--even the financially strong businesses--pay higher rates.

Question: What alternatives or modifications to current Federal credit programs available to rural areas would your organization consider appropriate?

Response: We think the Banks for Cooperatives and the Farm Credit System in general could become more involved in providing credit to promote economic development. We believe broader availability of credit from the System would foster a more competitive environment which would benefit rural residents and rural businesses.

Question: Has deregulation of the financial service industry served to increase, decrease or leave unchanged the supply of credit available for rural lending?

Response: Deregulation has contributed significantly to the competition for large, financially strong borrowers. For smaller businesses and rural residents, deregulation may have encouraged some commercial lenders to seek higher profits outside of the rural economy. Again, that is the reason it is important for rural areas to have a strong and flexible "dedicated" lender such as the Farm Credit System.

RESPONSES OF RICHARD LAROCHELLE TO ADDITIONAL WRITTEN QUESTIONS POSED BY THE COMMITTEE

National Rural Electric Cooperative Association

1800 Massachusetts Avenue, N.W.
Washington, D.C. 20036
Telephone: 202/857-9500

February 8, 1989

David Freshwater
Economist
Joint Economic Committee
United States Senate
Dirksen Senate Office Bldg., Room G-01
Washington, D.C. 20510

Dear Dave:

Enclosed are my comments to the supplemental questions from the JEC hearing on rural economic development. I hope that these responses will prove useful to you.

Dave, you are really to be complemented for having put together an excellent hearing and conference. I am looking forward to studying your report on this.

Thanks again for inviting NRECA to testify at your hearing.

Please let me know whenever I can help you. I am looking forward to continuing to work with you on economic development in your role with the Agriculture Committee.

Sincerely,

Rich Larochelle

Richard Larochelle
Legislative Representative
Rural and Economic Development

Enclosure

Answers of Richard Larochelle to Supplemental Questions from Joint Economic Committee Hearing on Rural Economic Development

1. Question: What do you understand the term "credit gap" to mean?

   Answer: The term "credit gap" is used to describe situations in which individuals or businesses are unable to obtain loans for certain purposes despite the fact that such loans could be profitably made.

   In a 1988 paper entitled "Rural Capital Markets Adequacy: Wisconsin Rural Non-farm Businesses", Glenn Rogers, Ron Schafer and Glenn Pulver described the issue of "capital gaps" as follows:

   > "There are currently two views concerning the functioning of rural capital markets. One view holds that capital is available for businesses to use but that there is a shortage of businesses and business ideas. The second view is that business ideas are there but the lack of capital is restricting rural growth and development. ... Worded as a null hypothesis this second view states that after adjusting for business specific risk, access to finance for rural non-farm businesses is equal across markets and business firms."

2. Question: Mr. Spies indicated that loan-to-deposit ratios in rural banks are at relatively low levels. Is this ratio consistent with the existence of a credit gap? If it is not, what can be done to expand the number of loans banks consider credit-worthy in rural areas?

   Answer: A low loan-to-deposit ratio means that banks have funds available to lend. This condition can exist along with a credit gap situation. In other words, banks may have funds available but choose, for whatever reasons, not to make them available to certain rural businesses.

   Rural lenders make a smaller proportion of their total loans to non-farm businesses than urban lenders. In some cases this may be due to the unfamiliarity of rural loan officers with these businesses. Training provided to rural loan officers in non-farm commercial lending could increase the availability of credit to such firms. This is particularly important because it is these types of firms which can help to bring diversity and growth to rural economies which are often disproportionately concentrated in agriculture and other resource based industries.

3. Question: Are there good reasons for the cost of capital to be higher in rural areas than in urban centers? If so, how would one go about determining what is an appropriate differential?

   Answer: Transaction costs may be one of the reasons for the cost of capital to be higher in rural areas. Higher transaction costs can result from both the smaller average size of rural loans and the smaller number of loans per bank.

Another possible cause of higher capital costs in certain rural areas is the perceived or real presence of greater risk and/or lower opportunities.

With respect to the question on "how would one go about determining what is an appropriate differential": this may be possible in the case of transaction costs, however, in the case of higher costs relating to risk, this would be difficult to quantify because it involves a substantial amount of judgement and understanding of business conditions specific to a local area.

4. Question: What alternatives or modifications to current Federal credit programs available to rural areas would your organization consider appropriate?

Answer: NRECA believes that local organizations must be the major actors in economic development efforts. Without local involvement, local investment, and local commitment, no development effort is likely to be successful in the long term.

Access to capital is an essential part of almost every development effort. In order to facilitate this access, we believe that efforts should be made to encourage existing organizations in rural communities to provide capital. Many of the existing programs of the Small Business Administration and the Farmers Home Administration serve a useful purpose in achieving this. The Farm Credit System also plays a valuable role.

Two specific alternatives which we believe merit careful consideration are:

a. To authorize the Rural Electrification Administration to provide funding for infrastructure and business development purposes, provided that this new authority be combined with the requirement that these federal funds be leveraged with private capital, including use of funds of the rural electric and telephone systems, or local banks, and other private funds. This proposal would build upon the network of 1,000 locally-owned and controlled rural electric cooperatives which provided service in 2,600 counties across America.

b. To develop a national capital access program which would provide an incentive for local banks to provide loans to rural businesses which may otherwise be unable to obtain such capital. Such a program could follow the successful example of the State of Michigan program. If such a program were operated by REA it could work as follows: a rural business unable to obtain credit under normal terms could be invited by a local bank, rural electric cooperative, or other entity to participate in the credit access program. If accepted by the lending institution, the business would obtain the loan and at the time of loan closing would pay a certain number of points (for example, three points), the bank or other financing organization would also pay three points, the rural electric or other sponsor would also pay three points and the REA would pay three points. All of the funds generated by these points would go into a reserve which would be held by REA for each financial institution. Funds from this reserve could be drawn upon by the local bank in the case of default on any of its loans in this program. This program would be one way of enhancing the availability of credit in rural communities in a way that would have several major advantages: (a) it would not replace local financial institutions as the primary providers of capital, it simply reduces their risk: (b) local businesses would obtain access to capital which would otherwise have been denied to them; (c) the government's risk would be finite -- in this example it would never exceed three percent of the principal amount of loans made in this program. This compares very favorably to loan guarantee programs in which the government exposure is very substantial; and (d) with a small amount of capital the government would be able to tremendously leverage the amount of private capital made available to rural small businesses, thereby promoting a large amount of rural business formation per dollar.

5. Question: Has deregulation of the financial service industry served to increase, decrease, or leave unchanged the supply of credit available for rural lending?

   Answer: The jury is probably still out on this question. What is known however, is that there is a real danger that deregulation will lead to a decrease of credit availability in rural communities. A number of structural factors could contribute to this, including: (a) the feeling, in some cases, that loans made to rural businesses may involve higher risk because of the wider cyclical trends and greater international competition associated with the major rural industries -- agriculture, resource extraction, and low-skill manufacturing; (b) the perception that a rural loan portfolio, even if profitable, is unlikely to provide as high a return as a portfolio comprised primarily of loans to businesses in faster growing urban and suburban areas; (c) the fact that loans to rural businesses are, on average, smaller in size and therefore may involve greater transaction costs; and (d) the relative unfamiliarity of managers of larger consolidated banks with the economic conditions of less populated rural branch areas, and the fact that management, given limitations on time, and a desire to achieve the greatest returns, may not view rural areas as high priority areas for their attention.

○